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SUPREME COURT, U.S.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1954

No. ~~457~~

CORN PRODUCTS REFINING COMPANY,
PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED NOVEMBER 22, 1954

CERTIORARI GRANTED JANUARY 10, 1955

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1954

No. 457

CORN PRODUCTS REFINING COMPANY,
PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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TRANSCRIPT OF RECORD IN TAX COURT

DOCKET NO. 20399 (1940).

The Tax Court of the United States

1

Docket No. 20399.

CORN PRODUCTS REFINING COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

2

Docket Entries.

APPEARANCES

For Petitioner: JAY O. KRAMER, Esq.
SAMUEL A. MCCAIN, Esq.

For Respondent: WALT MANDRY, Esq.

1948

Sep 20—Petition received and filed. Taxpayer notified. Fee paid. 3

Sep 21—Copy of petition served on General Counsel.

Sep 20—Request for hearing at New York City filed by taxpayer. Granted 9/29/48.

Oct 28—Answer filed by respondent.

Nov 1—Copy of answer served on taxpayer, New York City.

4 1950.

Mar 30—Entry of appearance of Jay O. Kramer as counsel filed.

Apr 6—Motion to set proceeding for hearing on the June 5, 1950 New York Calendar filed by petitioner.

Apr 11—Petitioner's motion filed April 6, 1950 is granted.

Apr 17—Hearing set June 5, 1950, New York.

Jun 13—Hearing had before Judge Murdock on merits.
5 Appearance of Samuel A. McCain as counsel filed. Stipulation of Facts with exhibits 1-A to 5-E filed at hearing. Briefs due Aug. 14, 1950; replies due September 13, 1950.

Jul 3—Transcript of Hearing 6/13/50 filed.

Aug. 10—Motion for extension to September 15, 1950 to file briefs and until Oct. 1, 1950 to file reply briefs filed by General Counsel. Granted 8/11/50.

Aug 14—Brief filed by taxpayer. Copy served 9/1/50.

Aug 31—Brief filed by General Counsel.

6 Sep 6—Motion for extension to Oct. 16, 1950 to file reply brief, filed by taxpayer. Granted 9/7/50.

Oct 10—Reply brief filed by taxpayer. Copy served.

Oct 18—Motion for leave to file the attached reply brief, brief lodged, filed by General Counsel. 10/18/50, granted.

1951

Feb 20—Findings of Fact and Opinion rendered, J. Murdock. Decision will be entered under Rule 50. Copy served.

Docket Entries.

Mar 19—Motion for reconsideration filed by petitioner. Denied 3/21/51. 7

Mar 19—Motion for review by entire Court filed by petitioner. Denied 3/21/51.

1953

Jun 8—Respondent's Computation filed with agreement thereon.

Jun 15—Decision entered, Judge Murdock, Div. 3.

Jun 25—Petition for review by U. S. Court of Appeals, Second Circuit, with Assignment of Errors filed by petitioner. 8

Jun 25—Proof of service filed.

Jul 8—Designation of contents of record with proof of service thereon filed by petitioner.

9

Petition.

10

[SAME TITLE.]

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (SN-IT-7) dated June 24, 1948, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation duly organized under the laws of the State of New Jersey, with its prin-
11 cipal office at 17 Battery Place, New York 4, New York. The return for the period here involved (1940) was filed with the Collector of Internal Revenue for the Second District of New York.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on June 24, 1948.

3. The taxes in controversy are income taxes for the calendar year 1940 representing a deficiency in the sum of $163,804.78 claimed by the Commissioner of Internal
12 Revenue as against a refund claimed by the petitioner.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner of Internal Revenue erred in failing to treat profits and losses realized by petitioner in 1940 from the purchase and sale of corn futures contracts as capital gains and losses, under Section 117 of the Internal Revenue Code, as limited by Section 118 of the Internal Revenue Code. This error resulted in an understatement of "Cost of Goods Sold" in the sum of $680,587.39; an understatement of recognized net short-

term capital gain in the sum of $62,328.10; and an understatement of recognized net long-term capital loss in the sum of $202,662.60. 13

(b) The Commissioner of Internal Revenue erred in understating the "Foreign Tax Credit".

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a)(1) In the return of the petitioner the sum of $680,587.39 representing net profit in 1940, from the purchase and sale of corn futures contracts, was treated as a reduction of the "Cost of Goods Sold." 14

(2) All such corn futures contracts were purchased through members of a recognized Commodity Exchange, in varying quantities. Such contracts were subject to the rules, regulations and customs of the Commodity Exchange where the trades were made, and when required were also made under authority of the Act of Congress known as the "Commodity Exchange Act."

(3) The purchase and sale of such corn futures contracts was confirmed by members of recognized Commodity Exchanges.

(4) The purchase and sale of corn futures contracts by the petitioner constitutes the purchase and sale of capital assets under the provisions of Section 117 (a) of the Internal Revenue Code. Such corn futures contracts were (i) not stock in trade or other property properly includible in inventory of the petitioner; (ii) the petitioner did not hold such corn futures contracts primarily for sale to customers in the ordinary course of petitioner's trade or business; and (iii) such corn futures contracts are not property, used in the petitioner's trade or business, of a character which is subject to the allowance for depreciation. 15

16 (5) The petitioner did not engage in hedging transactions in respect of the corn futures contracts which it purchased as defined in G. C. M. 17322 and the decisions of the Courts. Petitioner never sold corn futures contracts against its inventory position and never purchased corn futures contracts to protect long-term sales contracts of its products. Petitioner's purpose in acquiring corn futures contracts was to enable it, on the maturity dates of such contracts, to take in the corn called for therein, if there should be insufficient cash corn available in the market on such maturity dates to meet petitioner's requirements. The petitioner sold such contracts when it be-
17 came apparent that there would be sufficient cash corn available on their maturity dates to meet its requirements. Infrequently, when petitioner endeavored to sell such a contract, it could not find a buyer and therefore, had to take in the corn at the maturity date of the contract.

(6) The cost of the corn futures contracts purchased by the petitioner, which contracts were sold during 1940 and which were held for a period of not more than 18 months (such cost and holding period having been computed without the application of the provisions of Section 118 of the Internal Revenue Code) was $680,587.39 less than their
18 selling price.

(7) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1940 and which were held for a period of not more than 18 months (such basis and holding period having been computed in accordance with the provisions of Section 118 of the Internal Revenue Code) was $62,328.10 less than their selling price.

(8) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1940 and which were held for a period of more than 18 months (such basis and holding period having been computed in

accordance with the provisions of Section 118 of the Internal Revenue Code) was $202,662.60 more than their selling price. 19

(9) The sum of $680,587.39 set forth in paragraph 5 (a)(1), supra, was treated by the petitioner, in its return for 1940, in reduction of the "Cost of Goods Sold" as shown therein.

(10) The decisions of the Courts in the matters of (1) *Trenton Cotton Oil Company*, 147 F. (2d) 33 (rehearing denied, 148 F. (2d) 208), (2) *Estate of Dorothy Makransky*, 5 T. C. 397 (affirmed by CCA-3, 154 F. (2d) 59), and (3) *Stewart Silk Corporation*, 9 T. C. 174 (A. 1948-3-12739) were all promulgated after the filing of the petitioner's 1940 return. 20

(11) A corn futures contract is a security (*Trenton Cotton Oil Company*, 147 F. (2d) 33 (rehearing denied, 148 F. (2d) (208)).

(12) Section 118 of the Internal Revenue Code applicable to wash sales of securities is applicable to losses realized from the sale of corn futures contracts.

(b)(1) The Internal Revenue Agent's Report dated October 25, 1945 covering the examination of the 1940 return of Corn Products Refining Company and Refinacoes De Milho (consolidated return, form 1120) allowed a "Foreign Tax Credit" in the sum of $247,259.42, as shown in Exhibit "A" thereof. 21

(2) The Commissioner of Internal Revenue in his final determination (Exhibit "A", attached) did not increase the "Foreign Tax Credit" of $247,259.42 as set forth in paragraph 5 (b)(1), supra, to reflect the adjustments made to the above-mentioned Internal Revenue Agent's Report dated October 25, 1945.

22 (3) Based on the final determination of the Commissioner of Internal Revenue (Exhibit "A", attached) the "Foreign Tax Credit" should have been allowed in the sum of $339,007.88, as set forth in Exhibit "B" attached hereto and made part thereof.

Wherefore, the petitioner prays that this Court may hear the proceeding and grant the relief herein requested, together with any and all further relief that the Court may deem just and proper.

CORN PRODUCTS REFINING COMPANY

23 By: H. CALLENDER

H. Callender, Treasurer.

17 Battery Place,

New York 4, N. Y.

24

EXHIBIT A, ANNEXED TO PETITION.

Form 1279 (Rev. Mar. 1946)

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
New York 7, New York

Office of
Internal Revenue Agent
in Charge
2nd New York Division
90 Church Street—Room 1120

Jun 24 1948

Corn Products Refining Company
17 Battery Place
New York 4, New York

Sirs:

You are advised that the determination of your income tax liability and that of your affiliated company for the taxable year ended December 31, 1940 discloses a deficiency of $163,804.78, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Room 1120, 90 Church Street, New York 7, New York, for the attention of JPB-90D.

Exhibit A; Annexed to Petition.

The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

GEO. J. SCHOENEMAN,
Commissioner.
By (Signed) C. R. KRIGBAUM
Internal Revenue Agent in Charge.

Enclosures:
Statement
Form of waiver
JPB/fmd

STATEMENT

Corn Products Refining Company
17 Battery Place
New York 4, N. Y.

	Returns Examined	
	Form	Year
Parent Company		
Corn Products Refining Company 17 Battery Place New York 4, New York	1120	1940
Subsidiary Company		
Refinacoes de Milho, Brazil 17 Battery Place New York 4, New York	1122	1940

Tax Liability of Corn Products Refining Company and Refinacoes de Mi[illegible], Brazil, as provided for in

section 23.15 of Regulations 104 prescribed under section 141(b) of the Internal Revenue Code, for the taxable year ended December 31, 1940 31

	Liability	Assessed	Deficiency
Income Tax	$1,944,429.51	$1,780,624.73	$163,804.78

In accordance with section 23.16 of Regulations 104, the deficiency will be assessed severally against each corporation named above.

In making this determination of your income tax liability and that of your affiliated company, careful consideration has been given to reports of examination dated 32
February 25, 1943, August 28, 1944, February 28, 1945, and October 25, 1945; to your protests dated November 16, 1944, January 24, 1946, November 15, 1946, and supplemental data; to the statements made at the conferences held on December 18, 1946, January 13, 1947, January 15, 1947, April 16, 1947, May 13, 1947, May 16, 1947, August 21, 1947 and December 22, 1947; and to your claim for refund filed on May 9, 1945.

With respect to your claim for refund in which it is contended that there was an overpayment of income tax in the amount of $42,098.57 for the year 1940, you are advised that your contention cannot be conceded in view 33
of the findings set forth herein.

If a petition to The Tax Court of the United States is filed against the deficiency proposed herein, the issues set forth in your claim for refund should be made a part of the petition to be considered by The Tax Court in any redetermination of your tax liability. If a petition is not filed, the claim for refund will be disallowed and official notice will be issued by registered mail in accordance with section 3772 of the Internal Revenue Code.

The Italian and Brazilian dividends received by you have been accorded the same treatment as that for which you contended in each of the prior years, to wit, they

have been included in the taxable income for the year in which paid to you.

A copy of this letter and statement has been mailed to your representative, Mr. Milton M. Bernard, 10 East 40th Street, New York 16, New York, in accordance with the authority contained in the power of attorney executed by you.

ADJUSTMENTS TO CONSOLIDATED NET INCOME

Consolidated net income as disclosed by return		$8,745,356.62
Unallowable deductions and additional income:		
(a) Pension and profit-sharing payments	$185,280.39	
(b) Long-term capital loss disallowed (stock in German subsidiaries)	796,830.17	
(c) Excessive depreciation-machinery	407,894.02	
(d) Capital gains — foreign exchange:		
1—Long-term	210,667.36	
2—Short-term	28,260.71	
(e) Patent and development costs	81,081.94	
(f) Interest from Denmark	10,173.92	
(g) Loss on shipment to India	13,226.08	
(h) Foreign royalties	35,485.40	1,768,899.99
Total		$10,514,256.61

Exhibit A, Annexed to Petition.

Nontaxable income and additional deductions:			37
(i) Foreign dividends		$161,726.96	
(j) Capital stock tax		104,555.00	
(k) Patent depreciation		11,415.79	
(l) Short-term capital loss on bonds		5,718.27	
(m) Interest on defaulted bonds		7,718.13	
(n) Experimental expenses		43,041.65	
(o) Interest on Commodity Credit Corp. bonds		562.50	
(p) Interest due subsidiary		2,533.90	337,272.20 38
Consolidated net income as revised			$10,176,984.41

EXPLANATION OF ADJUSTMENTS

(a) It is determined that the amounts paid to, or on behalf of, employees of your subsidiary companies do not constitute expenses deductible by you under Section 23(a)(1)(A) of the Internal Revenue Code, since that section limits deductions to those paid or incurred by *the taxpayer* in carrying on a trade or business.

(b) Long-term capital loss in the amount of $796,830.17 from sale of stock in two German subsidiaries is held to be unallowable as a deduction in the year 1940. 39

(c) Deduction claimed for depreciation of machinery is held to be excessive in the amount of $407,894.02, as follows:

	Corn Products Refining Company	Refinacoes de Milho, Brazil	Totals
Claimed	$925,655.56	$48,498.78	$974,154.34
Allowed	542,469.37	23,790.95	566,260.32
Excess, disallowed	$383,186.19	$24,707.83	$407,894.02

Exhibit A, Annexed to Petition.

40 (d) 1. and 2—Long-term capital gain and short-term capital gain are increased by $210,667.36 and $28,260.71, respectively, to give effect to the correct amounts realized on the sales of foreign exchange.

(e) Patent and development costs in the amount of $81,081.94 are held to represent capital expenditures and are therefore unallowable as current deductions.

(f) Accrued interest from Denmark in the amount of $10,173.92, omitted from return, is held to be includible in taxable income for the year 1940.

41 (g) Loss of $13,226.58 claimed on shipment of corn to India is not applicable to the year 1940 and is, therefore, disallowed as a deduction for such year.

(h) and (i) Foreign royalties are increased by $35,485.40 and foreign dividends decreased by $161,726.96, to reflect the correct amounts reportable in respect of the following countries:

	Royalties		Dividends	
	Increase	(Decrease)	Increase	(Decrease)
Brazil	$15,205.77			$(101,448.93)
South Africa	3,224.78			
42 France	10,037.03			
Denmark	12,589.39			
Germany		(5,571.57)		(60,371.54)
Yugo Slavia			93.51	
Net Increase (Decrease)	$35,485.40			$(161,726.96)

(j) Deduction for Federal capital stock tax is increased by $104,555.00 to give effect to the correct amount accrued and allowable in the taxable year.

Exhibit A, Annexed to Petition.

(k) Deduction for patent depreciation is allowed in the amount of $11,415.79, the details of which have been furnished you. 43

(l) Short-term capital loss of $5,718.27 sustained on the sale of various bonds, not previously available as a deduction, is now allowed as an offset against short-term capital gains.

(m) The amount of $7,718.13 reported as interest on defaulted bonds of New York, New Haven & Hartford Railroad Company is held to represent a return of capital.

(n) A deduction is allowed in the amount of $43,041.65 for the year 1940, representing experimental expenses in connection with the improvement of production. 44

(o) The amount of $562.50 reported as interest on obligations of Commodity Credit Corporation is held to be excludible from taxable income.

(p) Deduction in the amount of $2,533.90 is allowed for the year 1940 in connection with interest due to your subsidiary, N. V. Corn Products Co., Holland.

Foreign tax credit is determined in the amount of $247,259.42, the details of which have been furnished you heretofore. 45

Exhibit A, Annexed to Petition.

46

COMPUTATION OF TAX

Internal Revenue Code as Amended

Income and Income Defense Taxes

Consolidated net income as revised		$10,176,984.41
Less: Interest on obligations of the United States		2,629.69
Consolidated adjusted net income		$10,174,354.72
Less: Dividends received credit		1,042,317.54
47 Consolidated normal-tax net income		$ 9,132,037.18
Income tax, 22.1% of $9,132,037.18		$ 2,018,180.22
Income Defense Tax, 1.9% of $9,132,037.18		173,508.71
Total income and income defense taxes		$ 2,191,688.93
Less: Foreign tax credit		247,259.42
Correct income and income defense tax liability		$ 1,944,429.51
48 Income and income defense taxes assessed:		
Original, Account No. 430000, September 1941 List	$1,595,879.60	
Additional, Account No. 529009, June 1943 List	184,745.13	1,780,624.73
Deficiency of income and income defense taxes		$ 163,804.78

Exhibit A, Annexed to Petition.

JPB-90D. 2nd New York Division 49

Form 870
Treasury Department
Internal Revenue Serv.
(Revised June 1941)

CORN PRODUCTS REFINING COMPANY

WAIVER OF RESTRICTIONS ON ASSESSMENT AND COLLECTION OF DEFICIENCY IN TAX

Pursuant to the provisions of section 272 (d) of the 50
Internal Revenue Code, and/or the corresponding provisions of prior internal revenue laws, the restrictions provided in section 272 (a) of the Internal Revenue Code, and/or the corresponding provisions of prior internal revenue laws are hereby waived and consent is given to the assessment and collection of the following deficiency or deficiencies in tax:

taxable year ended December 31, 1940 income tax in the sum of $163,804.78

taxable year ended ..... income tax in the sum of $..... 51

taxable year ended ..... income tax in the sum of $.....

taxable year ended ..... (declared value) excess-profits tax in the sum of $.....

taxable year ended ..... excess profits tax in the sum of $.....

taxable year ended ..... in the sum of $.....

Exhibit A, Annexed to Petition.

52 amounting to the total sum of $163,804.78
together with interest thereon as provided by law.

.....
(Taxpayer)

.....
(Taxpayer)

.....
(Address)

53 By.....

Date.....

Note: The execution and filing of this waiver at the address shown in the accompanying letter will expedite the adjustment of your tax liability as indicated above. It is not, however, a final closing agreement under section 3760 of the Internal Revenue Code, and does not, therefore, preclude the assertion of a further deficiency in the manner provided by law should it subsequently be determined that additional tax is due, nor does it extend
54 the statutory period of limitation for refund, assessment, or collection of the tax.

If this waiver is executed with respect to a year for which a JOINT RETURN OF A HUSBAND AND WIFE was filed, it must be signed by both spouses, except that one spouse may sign as the agent for the other.

Where the taxpayer is a corporation, the waiver shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered to sign for the corporation, in addition to which the seal of the corporation must be affixed.

EXHIBIT B, ANNEXED TO PETITION.

CORN PRODUCTS REFINING COMPANY AND REFINANCOES DE MILHO (CONSOLIDATED)

COMPUTATION OF CREDIT FOR FOREIGN TAXES—YEAR 1940 (BASED ON COMMISSIONER'S DETERMINATION AS SET FORTH IN 90-DAY LETTER DATED 6/24/48)

	Net Foreign Gross Income	Direct Foreign General Expense	Ratable H. O. Expense	Total Foreign Expense	Net Foreign Income	Ratio	Limitation 131-b-1	Foreign Taxes 131-a	Foreign Taxes 131-f	Total Foreign Taxes	Credit Allowable
						$9,132,037.18	$2,191,688.93				
Argentina	$ 183,681.54	$ 2,780.56	$ 13,216.63	$ 15,997.19	$ 167,684.35	.01836221	$ 40,244.25	$ 9,091.53		$ 9,091.53	$ 9,091.53
Australia		107.12		107.12	*107.12*						
Australia											
Belgium	*444.76*	134.74		134.74	*579.50*						
Brazil	227,607.65	3,407.55	15,937.81	19,345.36	208,262.29	.02280568	49,982.96	1,216.46		1,216.46	1,216.46
Canada	233,685.15	253.44	16,363.37	16,616.81	217,068.34	.02376998	52,096.40	10,076.26	54,918.42	64,994.68	52,096.40
Canary Islands											
China	*6,807.76*	4,986.06		4,986.06	*11,793.82*						
Columbia	8,812.95	1,116.45	618.04	1,734.49	7,078.46	.00077512	1,698.82	306.63		306.63	306.63
Cuba	*564.71*	19.60	133.04	152.64	*717.38*						
Czechoslovakia	104.32	8.67	7.30	15.97	88.35						
Denmark	22,007.89	4.17	1,593.96	1,598.13	20,409.76						
Dominican Republic											
Dutch East Indies											
Egypt	6,594.00	201.10	462.05	663.15	5,930.85	.00064946	1,423.41	410.68	1,299.20	1,709.88	1,423.41
England	576,125.52	39,651.12	41,182.29	80,833.41	495,292.11	.05423676	118,870.11	704.92	141,187.25	141,892.17	118,870.11
France	*23,352.68*	44,185.08	834.12	45,019.20	*68,371.88*						
Germany	573,852.37	14,721.54	40,182.96	54,904.50	518,947.87	.05682717	124,547.48	36,477.41	8,528.84	45,006.25	45,006.25
Greece											
Holland	365,359.43	673.65	25,760.37	26,434.02	338,925.41	.03711389	81,342.10		75,670.31	75,670.31	75,670.31
Hungary											
India	*28,226.51*	931.19	2,046.71	2,977.90	*31,204.41*						
Italy	140,752.24	13,135.38	9,856.45	22,991.83	117,760.41						
Japan	174,966.00	31,287.30	12,251.67	43,538.97	131,427.03	.01439186	31,542.48	18,030.59	50,774.34	68,804.93	31,542.48
Mexico	30,565.30	5,142.90	2,140.28	7,284.18	23,281.12	.00254939	5,587.47	3,305.17		3,305.17	3,305.17
Netherlands E. Indies	*1,319.23*				*1,319.23*						
New Zealand	*1,998.50*	11.46		11.46	*2,009.96*						
Nicaragua											
Others	2.38	17,758.56	.17	17,758.73	*17,756.35*						
Phillipines		6,667.88		6,667.88	*6,667.88*						
Poland											
Puerto Rico		404.32		404.32	*404.32*						
Portugal	*5.96*				*5.96*						
Santo Domingo		376.76		376.76	*376.76*						
South Africa	*799.13*	.50	225.80	226.30	*1,025.43*						
Switzerland	2,412.85	225.75	190.76	416.51	1,996.34	.00021861	479.13	863.45	1,373.23	1,536.68	479.13
Turkey											
Yugoslavia	*6,028.47*	997.05	406.00	1,403.05	*7,431.52*						
Total	$2,476,981.85	189,190.90	183,409.78	372,600.68	2,104,381.17						339,007.88

[Figures in italics were red in original.]

Answer.

58

[SAME TITLE.]

The respondent, by his attorney, Charles Oliphant, Chief Counsel for the Bureau of Internal Revenue, for answer to the petition heretofore filed in this proceeding, admits, denies, and avers as follows:

1. Admits the allegations of paragraph 1 of the petition.

59

2. Admits the allegations of paragraph 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar year 1940, in which a deficiency is asserted by respondent, but respondent denies all other allegations of paragraph 3 of the petition.

4. (a) and (b) Denies each severally the allegations of sub-paragraphs (a) and (b) of paragraph 4 of the petition.

60

5. (a) (1) Admits the allegations of sub-subparagraph (1) of subparagraph (a) of paragraph 5 of the petition.

(2) to (5), inclusive. Denies each severally the allegations of sub-subparagraphs (2) to (5), inclusive, of subparagraph (a) of paragraph 5 of the petition.

(6) Admits the allegations of sub-subparagraph (6) of subparagraph (a) of paragraph 5 of the petition.

(7) and (8) Denies each severally the allegations of sub-subparagraphs (7) and (8) of subparagraph (a) of paragraph 5 of the petition.

(9) Admits the allegations of sub-subparagraph (9) of subparagraph (a) of paragraph 5 of the petition. 61

(10) and (11) Respondent shows unto the Court that sub-subparagraphs (10) and (11) of subparagraph (a) of paragraph 5 of the petition contain no allegations of fact and are irrelevant, immaterial and impertinent to the petition herein; in so far as said sub-subparagraphs, or either of them, are considered of any materiality in said petition they are denied.

(12) Denies the allegations of sub-subparagraph (12) of subparagraph (a) of paragraph 5 of the petition.

62

(b) (1), (2) and (3) Denies each severally the allegations of sub-subparagraphs (1), (2) and (3) of subparagraph (b) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified, or denied.

WHEREFORE, it is prayed that the appeal be denied.

Signed CHARLES OLIPHANT
HDT 63
CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

R. P. HERTZOG,
Division Counsel.

HENRY C. CLARK,
Special Attorney,
Bureau of Internal Revenue.

HCC:rgg 10/25/48

Findings of Fact and Opinion.

64

16 T. C. No. 49

[SAME TITLE.]

Docket No. 20399. Promulgated February 20, 1951.

WASH SALES—SECURITIES—SUBSTANTIALLY IDENTICAL—COMMODITY FUTURES—SECTION 118.—Contracts for the delivery of corn for a stated price at a stated future time are not securities within the
65 meaning of section 118 and one such contract is not substantially identical with another where the date for delivery is different and the contract price and the other contracting party may be different.

Jay O. Kramer, Esq., for the petitioner.

Walt Mandry, Esq., for the respondent.

The Commissioner determined a deficiency of $163,804.78 in the income tax of the petitioner and an affiliate for 1940. The issues in dispute are whether profits and losses of the petitioner resulting from purchases and sales of
66 corn futures are capital gains and losses within the meaning of section 117 and, second, whether the wash sales provisions of section 118 apply to those transactions.

FINDINGS OF FACT

The petitioner filed a consolidated corporate income tax return for 1940 with the collector of internal revenue for the second district of New York.

The petitioner is a nationally known corporation engaged in the manufacture and sale of corn products, including starches, sugars, syrups, oils, and feeds.

The maximum amount of raw corn which the petitioner

could store in its own plants during 1940 was 2,303,000 bushels. That quantity would keep it supplied for less than three weeks. The daily grind capacity of the plants of the petitioner during 1940 was 147,700 bushels. Similar conditions existed in prior years. 67

The principal product obtained by the petitioner from raw corn is starch. Cerelose is a refined sugar derived from starch. It competes with cane and beet sugars, but at a lower price, and constituted 15.93 per cent of the total sales of the petitioner in 1940.

A corn future consists of a contract to buy 5,000 bushels of corn, or some multiple thereof, of a stated quality, at a stated price, during a stated month in the future. The contracts involved were for delivery at a stated time within eleven months or less of the date of the contract. The party contracting to furnish the corn has the option of delivering the corn on any day during the month in which the contract matures and has the option of furnishing a different grade of corn at an appropriate adjustment in price. The transactions are made through a broker on a commodity exchange. The buyer furnishes his broker with a percentage, or margin, of the contract price of the corn until delivery is taken or the contract is sold, at which time final settlement is made. The contracts are freely dealt in on the commodity exchange. 68 69

The petitioner began to buy and sell corn futures in 1932 and continued that practice through 1940. It engaged in those futures transactions as a part of its corn buying program and as the most economical method of obtaining an adequate supply of raw corn in view of its limited storage facilities and the expense of increasing those facilities sufficiently to take care of its needs. Purchases of futures were made when the price of corn was advantageously low.

High corn costs following droughts in 1934 and 1936 resulted in losses on cerelose sales made by the petitioner

70 in 1937. The petitioner, in order to avoid or minimize similar losses, increased its buying of corn futures so that it would have corn available at prices which permitted it to sell cerelose in competition with beet and cane sugar. It never reached its goal of a long position of 12,000,000 bushels.

The petitioner took delivery of corn on some of its future contracts, but usually sold most of its corn futures in early summer if it then appeared that there would be no shortage of corn and no great danger of increased prices, but if the crop was poor, or there was danger of an increase in price, it sold its futures gradually as it
71 bought corn for grinding. The petitioner would begin to acquire additional futures contracts at harvest time each year.

The outbreak of World II in 1939 raised the price of cane and beet sugars to such an extent that the petitioner no longer needed the futures to assist it in selling cerelose successfully in competition with those sugars. It owned futures at the beginning of 1940 for the purchase of over 8,000,000 bushels of corn. That long position was reduced, beginning in about June, so that, at the end of the year, it had futures covering only about 1,400,000 bushels.

72 It was the petitioner's practice to account for its profits or losses on corn futures in an account entitled "Corn Miscellaneous". The balance in that account, at the end of each year prior to 1940, was debited or credited to cost of sales and in 1940, the profit balance of $680,587.39 was used to reduce "Cost of Goods Sold".

The Commissioner, in determining the deficiency for 1940, made no change in "Cost of Goods Sold" as reported by the petitioner on its return.

The transactions in futures resulted in losses of $816,164.03 for 1938 and of $424,437.54 for 1939, and a net profit of $680,587.39 for 1940.

The following table shows for three years the futures

purchased, those sold, and those under which delivery was taken, together with the amount of corn purchased and received at the plants: 73

Year	Futures purchased Contracts	Futures purchased Bushels	Futures sold Contracts	Futures sold Bushels	Futures under which delivery was taken Contracts	Futures under which delivery was taken Bushels	Bushels of Corn Purchased and Received at the plants Bushels
1938	824	19,675,000	755	17,400,000	192	4,975,000	35,650,773
1939	593	14,470,000	535	14,180,000	114	2,865,000	36,806,869
1940	437	8,125,000	728	14,595,000	24	250,000	37,222,409

The general sales policy of the petitioner, at all times material hereto, was to enter into contracts providing for shipment of the goods within thirty days and stating a definite price, but providing that the price should be that stated in the contract or the price in effect at date of delivery, whichever was lower. There were exceptions and variations to this general policy. One was that the petitioner, on January 15, 1940, invited all buyers to submit on or prior to January 20, orders for cerelose to be delivered as late as June 30, 1940. The buyer was guaranteed the lower of the January 15 price or the price in effect at date of delivery. The buyers were allowed to cancel all or parts of the amounts of the goods ordered. The petitioner received a great many orders in response to that invitation. Another exception was that the canning trade on the Pacific Coast was allowed to call on the petitioner for cerelose for delivery in more than thirty days. Cancellations were allowed in this situation also and the buyers were allowed the lower of the contract price or the price in effect at the date of delivery. The petitioner also agreed to furnish starch to two companies on what was, in effect, a cost plus basis. 74 75

The stipulation of facts is incorporated herein by this reference.

76

OPINION

MURDOCK, *Judge*: The parties have argued two points. One is whether contracts for the future delivery of corn are to be treated as capital assets in the hands of the petitioner so that gains or losses thereon are capital gains or loses, and the other is whether the wash sales provisions of section 118 apply to those transactions. The petitioner has not accounted for or reported its gains and losses from future transactions as capital gains and losses but, on the contrary, treated the 1940 gains as a reduction
77 in the cost of raw materials and the losses in prior years as an addition to the cost of goods sold. It thus reduced its income for prior years by the full amount of large losses sustained in those years on futures transactions and, being consistent, in 1940 reduced the cost of goods sold by the full amount of the 1940 gain. The Commissioner, in determining the deficiency, made no change in the taxpayer's treatment of the futures transactions and now insists that no change is necessary or proper. Nevertheless, the petitioner now seeks to have the transactions regarded as resulting in capital gains and losses within section 117.

78 Success on that point would have no effect on the tax liability in this case unless the second contention of the petitioner is also sustained. The petitioner sustained a short-term capital loss of $5,718.27 on bonds and it did not show any short-term capital gains on its return against which to offset that loss. However, the Commissioner, in determining the deficiency, held that there were short-term capital gains of $28,260.71 on foreign exchange and allowed the short-term capital losses to be deducted in full. His action in this respect is not challenged in this proceeding. The tax is the same whether the $680,587.39 reduces cost of goods sold or is taxed as a short-term capital gain. Thus, it is not necessary to decide in this

case whether or not section 117 applies to the futures 79
transactions unless it is held that section 118 also applies. The question of whether transactions in commodity futures are within section 117 is a difficult one as is shown by prior decisions cited by the parties. While there would seem to be logic and common sense in the position which the Commissioner now takes and which the petitioner has always taken in accounting for these transactions, nevertheless, the Court expresses no opinion on that subject at the present time.

Section 118 of the Internal Revenue Code was enacted to prevent a deduction for losses sustained in wash sales 80
of securities; that is, where the taxpayer at or about the time of a sale acquires identical or substantially identical securities. The deduction is postponed until the securities are disposed of and not replaced within 30 days. It provides that no deduction for loss shall be allowed under section 23(f), with exceptions not here material, if the loss is claimed to have been sustained from any sale "of shares of stock or securities" where within 30 days before or after the sale the taxpayer has acquired "substantially identical stock or securities". Other provisions are to the effect that the basis and the holding period of the securities sold attach to the securities purchased where the wash 81
sale provision has applied. The petitioner, by tracing its loss transactions of prior years and assuming that a number of those transactions were wash sales within the meaning of section 118, arrives at bases for the futures sold in 1940 which would show capital gains of $62,328.10 and capital losses of $202,662.60 instead of the gain of $680,587.39 which it reported in accordance with its consistent method of accounting. It relies on *Trenton Cotton Oil Company* v. *Commissioner*, 147 Fed. (2d) 33, rehearing denied 148 Fed. (2d) 208, reversing on this point a memorandum opinion of this Court.

We are unable to agree with the opinion in the cited

82 case holding that the words "stocks and securities", as used in section 118, include commodity futures and that a new future contract is "substantially identical" with a prior contract. The Appellate Court reasoned that the futures contracts were securities because they were pledged with the broker "who advanced the necessary funds to purchase the oil". Any pledged property is a security in that sense, but obviously not all pledged property is a security within the meaning of section 118. Furthermore, the reasoning is unsound since the broker does not advance the funds necessary to purchase the commodity. The
83 buyer of a commodity future contract puts up a margin with his broker which is a percentage of the purchase price called for in the contract. That margin is held as security until the contract is closed out. If the purchaser of the contract takes delivery of the corn, he then pays the additional amount called for under the contract, but if he sells the contract he gets credit for the margin which he put up with his broker, plus the price at which the broker sold the contract, and neither he nor the broker makes any further payment on account of the purchase price which that particular purchaser owed under the contract. The Appellate Court also reasoned that the
84 futures contract was "a security" because "the petitioner had no more than a document giving it the right to demand and receive property not in its possession". The owner of a commodity future has no right to demand the property except at maturity upon payment of the contract price. All executory contracts giving a person the right to demand and receive property upon the payment of a contract price are not to be regarded as securities within the meaning of section 118.

Furthermore, a new future commodity contract is not "substantially identical" with any prior contract even though the quantity involved in each is identical. It would be purely accidental if the new contract was with the same

party as the one who had agreed to sell the commodity in the earlier contract. The price would probably be different and the delivery date would certainly be different. The United States District Court, Middle District of Georgia, on April 11, 1940, in the case of *Valley Waste Mills* v. *Page*, 27 A. F. T. R. 957, held, in regard to cotton futures, that the new contract was not "substantially identical" with the old one under such circumstances and, with that, we agree. Cf. section 117(1)(3)(B) as added by section 211, Revenue Act of 1950. Cotton futures were considered by the Circuit Court of Appeals for the Fifth Circuit in *Valley Waste Mills* v. *Page*, 115 Fed. (2d) 466, certiorari denied 312 U. S. 681, and it is apparent from the opinion there that such a future is not a security in any generally recognized sense but simply a contract between two parties in which one agrees to supply at a designated time in the future a stated quantity and quality of goods, upon payment of a stated price and on which a part of the contract price, called a margin, has been paid by the buyer to his broker to bind him until the sale is consummated or the contract is sold. See also *Rosenthal* v. *Brown*, 247 N. Y. 479, 160 N. E. 921. Cf. *Pinellas Ice & Cold Storage Co.* v. *Commissioner*, 287 U. S. 462; *Commissioner* v. *Seagall*, 114 Fed. (2d) 706; *Commissioner* v. *Sisto Financial Corporation*, 139 Fed. (2d) 253. Corn futures are not different in this respect from cotton futures. Furthermore, corn futures, such as are here involved, are for such short periods and are of such a peculiar character that they do not lend themselves to the evil which section 118 was intended to prevent. Sales of such contracts are completed transactions when made, the gain or loss is recognized at that time, and there is no postponement of the gain or loss for tax purposes. *Valley Waste Mills* v. *Page*, *supra*; *Robert M. Harriss*, 44 B. T. A. 999, affirmed 143 Fed. (2d) 279. Section 118 has no application in this case.

Findings of Fact and Opinion.

88 The parties have stipulated that certain adjustments are to be made in computing the tax liability of the petitioner.

Decision will be entered under Rule 50.

(Seal)

Decision.

[SAME TITLE.]

89

The parties filed an agreed computation on June 8, 1953, pursuant to the Court's Findings of Fact and Opinion promulgated February 20, 1951: Therefore, it is

ORDERED and DECIDED, that there is a deficiency ir income tax for the year 1940 in the amount of $80,731.19.

(Signed) J. E. MURDOCK
Judge

90 ENTERED JUN 15, 1953

Enter:

(Seal)

Stipulation of Facts.

91

[SAME TITLE.]

It is hereby stipulated by and between the parties hereto through their attorneys that the following facts may be taken to be true for the purposes of this proceeding without prejudice to the rights of either party to introduce other and further evidence not inconsistent herewith:

1. Petitioner is a corporation organized under the laws of the State of New Jersey on February 6, 1906, with its principal office at 17 Battery Place, New York 4, N. Y. 92

2. Its consolidated income tax return for the calendar year 1940 was filed with the Collector of Internal Revenue, Second District of New York.

3. The deficiency letter (a copy of which is annexed to the petition) was mailed to petitioner on June 24, 1948.

4. The taxes in controversy are income taxes. The amount of the deficiency asserted by respondent in his notice of deficiency is $163,804.78, while petitioner claims that it has overpaid its taxes for the year 1940. 93

5. Petitioner is a nationally known corporation engaged in the manufacture and sale of corn products, including starches, syrups, oils, and other corn derivatives.

6. Its products are sold to subsidiaries, affiliated companies, and to outside customers.

7. During the year 1940 petitioner derived a net profit of $680,587.39 from the purchase and sale of corn futures contracts.

94 8. This profit of $680,587.39 was treated in petitioner's tax return for the year 1940 as a reduction of "Cost of Goods Sold." In its tax returns for prior years the petitioner treated the gains or losses resulting from purchase and sale of corn futures contracts as a reduction of, or as an addition to, cost of sales.

9. It had been the custom of petitioner for a number of years prior to 1940 to purchase corn futures contracts.

10. All corn futures contracts purchased and sold during 1940 were purchased and sold through members of a
95 recognized Commodity Exchange.

11. Such contracts were subject to the rules, regulations and customs of the Commodity Exchange where the trades were made.

12. The cost of the corn futures purchased by petitioner, which contracts were sold during 1940, and which were held for a period of not more than 18 months, was $680,387.39 less than their selling price (computed without the application of Section 118 of the Internal Revenue Code).

96

13. The basis of the corn futures contracts purchased by petitioner, which contracts were sold during 1940, and which were held for a period not more than 18 months, was $62,328.10 less than the selling price when their basis and holding period are computed in accordance with the provisions of Section 118 of the Internal Revenue Code; but nothing contained in this paragraph shall constitute a concession by respondent of the legal conclusions that the corn futures contracts in question were "capital assets" within the meaning of Section 117 of the Internal Revenue Code, or that Section 118 applies thereto. See Exhibit 1-A attached hereto.

14. The basis of the corn futures contracts purchased by petitioner, which contracts were sold during 1940, and which were held for a period of more than 18 months, was $202,662.60 more than their selling price when their basis and holding period are computed in accordance with the provisions of Section 118 of the Internal Revenue Code; but nothing contained in this paragraph shall constitute a concession by respondent of the legal conclusions that the corn futures contracts in question were "capital assets" within the meaning of Section 117 of the Internal Revenue Code or that Section 118 applies thereto. See Exhibit 1-A attached hereto. 97

15. The corn futures contracts in question were not subject to depreciation. 98

16. The raw corn storage capacity of petitioner in its own plants during 1940 of 2,303,000 bushels was less than three weeks' supply. The daily grind capacity of petitioner during 1940 was 147,700 bushels.

17. The annexed schedule (marked Exhibit 2-B) shows the monthly purchases of raw corn by petitioner from January, 1938 to December, 1940, inclusive. 99

18. The annexed schedule (marked Exhibit 3-C) shows the monthly purchases of corn futures contracts by petitioner from January, 1938 to December, 1940, inclusive, including the number of contracts, the number of bushels and the maturity dates, which futures contracts were disposed of by sale.

19. The annexed schedule (marked 4-D) shows the monthly purchases of corn futures contracts by petitioner from October, 1937 to December, 1940, inclusive, including the number of contracts, the number of bushels and the

100 maturity dates, under which contracts delivery of the corn was taken.

20. The annexed schedule (marked Exhibit 5-E) shows the monthly sales of corn futures contracts by petitioner from January, 1938 to December, 1940, inclusive, including the number of contracts and the number of bushels.

21. It is agreed that the amount of the credit for foreign taxes shall be determined and effect given thereto under Rule 50.

101 22. It is agreed that the net taxable income as shown in the notice of deficiency shall be increased by the sum of $9,975.42, representing an embezzled amount deducted in the return for which the petitioner has been reimbursed by insurance, and effect will be given thereto under Rule 50. The respondent hereby asserts claim for any increased deficiency resulting therefrom.

23. It is agreed that by the use of certain terms in the stipulation and exhibits, which connote the purchase and sale of corn futures contracts, the parties have used
102 trade terms and by such use do not intend to suggest the legal consequences flowing from such transactions.

JAY O. KRAMER
Attorney for Petitioner

(Signed) CHARLES OLIPHANT
RPH
Chief Counsel,
Bureau of Internal Revenue

EXHIBIT 1-A, ANNEXED TO STIPULATION OF FACTS.

CORN PRODUCTS REFINING COMPANY

SUMMARY OF ADJUSTMENTS OF CAPITAL GAINS OR *LOSSES* RESULTING FROM THE APPLICATION OF THE WASH SALE PROVISION OF THE INTERNAL REVENUE CODE, SECTION 118, TO TRADING IN CORN FUTURES CONTRACTS

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
	Contracts Sold		Selling Expenses			Book Profit or *Loss* Exclusive of Tax			Adjustment of Book Profit or *Loss* Through Application of Section 118, I. R. C.						
Year	Sales Price	Purchase Price	Commission	Tax	Book Profit or *Loss*	Total Book Profit or *Loss* (See Schedule I, Columns 8, 9 and 10)	6 Months and under	6 to 18 Months	Wash Losses (Add'l. Costs)	6 months and Under	6 to 18 Months	18 to 24 Months	Over 24 Months	Total Adjusted Profit or *Loss*	Wash Losses (Disallowed)
Domestic—United States															
1936	$ 589,900.00	$ 506,668.75	$ 700.00	$ 177.12	$ 82,354.13	$ 82,531.25	$ 82,531.25	$ —	$ —	$ 82,531.25	$ —	$ —	—	$ 82,531.25	$ —
1937	3,660,475.00	3,093,106.25	4,100.00	1,099.83	562,168.92	563,268.75	182,193.75	381,075.00	1,893.75	183,600.00	381,075.00	—	—	564,675.00	3,300.00
1938	9,434,281.25	10,229,806.25	19,937.57	701.46	*816,164.03*	*815,462.57*	*599,240.70*	*216,221.87*	421,593.80	10,606.24	*70,049.99*	—	—	*59,443.75*	1,177,612.62
1939	6,950,075.00	7,357,100.00	17,412.54	—	*424,437.54*	*424,437.54*	92,453.09	*516,890.63*	1,798,862.68	*2,350.00*	*220,121.90*	*23,453.13*	1,375.00	*244,550.03*	1,978,750.19
1940	8,866,006.25	8,167,637.50	17,781.36	—	680,587.39	680,587.39	192,271.81	488,315.58	1,341,067.36	*34,384.39*	96,712.49	1,393.75	*204,056.35*	*140,334.50*	520,145.47

Year 1940

Held less than 18 months

Column (10)	$ *34,384.39*
Column (11)	96,712.49
Per Par. 13 of Stipulation	62,328.10

Held more than 18 months

Column (12)	1,393.75
Column (13)	*204,056.35*
Per Par. 14 of Stipulation	$202,662.60

[Figures in italics were red in original.]

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EXHIBIT 2-B, ANNEXED TO STIPULATION OF FACTS.

CORN PRODUCTS REFINING COMPANY

BUSHELS OF CORN PURCHASED AND RECEIVED AT PLANTS BY MONTHS FROM 1938 TO 1940, INCLUSIVE

Year	Month	Bushels of Corn
1938	Jan.	3,064,477.28
	Feb.	2,879,397.48
	Mar.	2,368,563.32
	Apr.	3,055,833.32
	May	2,685,153.32
	June	2,736,779.36
	July	3,289,083.12
107	Aug.	3,288,061.44
	Sept.	2,712,331.24
	Oct.	3,445,492.48
	Nov.	3,278,543.52
	Dec.	2,847,057.28
	Total	35,650,773.16
1939	Jan.	3,037,691.24
	Feb.	2,440,180.20
	Mar.	2,446,591.44
	Apr.	3,357,578.32
	May	3,887,365.40
	June	2,709,739.36
	July	2,345,003.32
	Aug	3,309,002.28
	Sept.	3,658,137.48
	Oct.	3,887,427.08
108	Nov.	2,687,371.04
	Dec.	3,040,782.08
	Total	36,806,869.24
1940	Jan.	3,080,950.40
	Feb.	3,640,226.16
	Mar.	2,429,236.44
	Apr.	3,378,374.56
	May	3,627,996.04
	June	3,184,761.04
	July	2,806,706.04
	Aug.	2,554,081.44
	Sept.	3,354,588.52
	Oct.	3,016,839.46
	Nov.	2,669,977.08
	Dec.	3,478,672.08
	Total	37,222,409.26

EXHIBIT 3-C, ANNEXED TO STIPULATION OF FACTS.

CORN PRODUCTS REFINING COMPANY

ANALYSIS OF CORN FUTURES CONTRACTS PURCHASED AND SOLD YEARS 1938 THROUGH 1940

File 141.8 Page	1938 Purchases Month	No. of Contracts	M. Bu.	MATURITY May, 1938 No. of Contracts	M. Bu.	July, 1938 No. of Contracts	M. Bu.	September, 1938 No. of Contracts	M. Bu.	December, 1938 No. of Contracts	M. Bu.	May, 1939 No. of Contracts	M. Bu.	July, 1939 No. of Contracts	M. Bu.	September, 1939 No. of Contracts	M. Bu.
44	January	93	1,670	13	265	1	40	79	1,365								
48	February	57	1,165	4	75	1	50	52	1,040								
52	March	71	1,945			3	115	63	1,750	5	80						
57	April	17	245					14	220	3	25						
58	May	51	1,205					19	435	32	770						
61	June	49	1,165			1	10			48	1,155						
65	July	150	3,960					5	1,050	112	2,095	33	815				
75	August	182	4,155							14	135	168	4,020				
87	September	97	2,080									89	1,975	8	105		
93	October	28	680									7	110	19	470		
95	December	29	1,405							2	100					29	1,405
		824	19,675	17	340	6	215	232	5,860	216	4,360	297	6,920	27	575	29	1,405

File 141.8 Page	1939 Purchases Month	No. of Contracts	M. Bu.	July, 1939 No. of Contracts	M. Bu.	September, 1939 No. of Contracts	M. Bu.	December, 1939 No. of Contracts	M. Bu.	May, 1940 No. of Contracts	M. Bu.	July, 1940 No. of Contracts	M. Bu.	September, 1940 No. of Contracts	M. Bu.
99	January	60	2,495			60	2,495								
106	February	5	65			5	65								
106	March	16	535			16	535								
107	April	27	805	1	15	26	790								
110	May	1	10	1	10										
110	June	11	305					11	305						
111	July	81	1,640					13	215	68	1,425				
115	August	133	3,745							133	3,745				
126	September	100	2,160					7	190	75	1,620	18	350		
132	October	59	605							1	5	58	600		
134	November	53	1,195									53	1,195		
137	December	47	910									37	660	10	250
		593	14,470	2	25	107	3,885	31	710	277	6,795	166	2,805	10	250

File 141.8 Page	1940 Purchases Month	No. of Contracts	M. Bu.	July, 1940 No. of Contracts	M. Bu.	September, 1940 No. of Contracts	M. Bu.	December, 1940 No. of Contracts	M. Bu.	May, 1941 No. of Contracts	M. Bu.	July, 1941 No. of Contracts	M. Bu.
141	January	89	1,720	11	115	77	1,600	1	5				
145	February	34	625	7	50	27	575						
147	March	33	440	1	5	32	435						
148	April	69	1,505			69	1,505						
153	May	74	1,465			74	1,465						
161	June	30	595					30	595				
162	July	2	100							2	100		
163	August	51	905					1	5	50	900		
165	September	34	475					14	105	18	355	2	15
167	October	21	295					3	40	1	5	17	250
		437	8,125	19	170	279	5,580	49	750	71	1,360	19	265

EXHIBIT 4-D, ANNEXED TO STIPULATION OF FACTS.

CORN PRODUCTS REFINING COMPANY

ANALYSIS OF CORN FUTURES CONTRACTS UNDER WHICH DELIVERY OF CORN WAS TAKEN YEARS 1937 TO 1940, INCLUSIVE

		Purchases			DELIVERY																					
					May, 1938			July, 1938																	
Year	Month	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value																
1937	Oct.	15	275	$ 167,256.25	15	275	$158,956.25																			
	Nov.	62	780	445,968.75	37	505	281,468.75	25	275	$ 155,712.50																
	Dec.	12	160	93,725.00	7	55	29,453.75	5	105	61,462.50																
		89	1215	706,950.00	59	835	469,878.75	30	380	217,175.00																
					May, 1938			July, 1938			September, 1938			December, 1938			March, 1939			May, 1939			July, 1939		
1938	Jan.	22	345	207,443.75	11	260	131,675.00				11	85	$ 43,237.50												
	Feb.	9	100	61,287.50							9	100	51,575.00												
	Mar.	4	155	98,037.50							4	155	79,675.00												
	Apr.	3	120	75,062.50							3	120	61,350.00												
	May	18	755	434,037.50	14	560	315,181.25				4	195	99,450.00												
	July	9	400	233,381.25				4	200	116,143.75															
	Aug	49	1230	641,187.50										5	200	$ 95,575.00									
	Sept.	27	510	264,025.00													8	500	$235,025.00	41	730	$349,312.50			
	Oct.	23	705	353,006.25																27	510	244,025.00			
	Nov.	28	655	335,275.00																			23	705	$334,875.00
																							28	655	310,775.00
		192	4975	2,702,743.75	25	820	446,856.25	4	200	116,143.75	31	655	335,287.50	5	200	95,575.00	8	500	235,025.00	68	1240	$593,337.50	51	1360	$645,650.00
					May, 1939			July, 1939			September, 1939			December, 1939			May, 1940								
1939	Jan.	27	730	397,306.25							27	730	362,687.50												
	Feb.	10	140	68,906.25							10	140	79,350.00												
	Mar.	11	165	80,206.25							14	165	82,537.50												
	Apr.	19	525	263,331.25				9	285	134,912.50	10	240	109,600.00												
	May	15	755	383,293.75	5	445	224,737.50	10	310	146,650.00															
	Sept.	11	285	148,475.00																					
	Oct.	17	165	80,893.75										6	200	103,162.50	5	85	53,125.00						
	Dec.	4	100	52,250.00										2	10	5,212.50	15	155	100,055.00						
														4	100	52,437.50									
		114	2865	1,474,662.50	5	445	224,737.50	19	595	281,562.50	58	1275	634,175.00	12	310	$160,812.50	20	240	$153,180.00						
					July, 1940			September, 1940			May, 1941														
1940	Jan.	5	30	17,018.75	5	30	20,100.00																		
	Feb.	1	10	5,475.00	1	10	6,700.00																		
	May	3	55	36,912.50				3	55	34,512.50															
	Aug.	6	50	27,168.75							6	50	33,937.50												
	Sept.	6	85	51,737.50				1	55	34,675.00	5	30	20,662.50												
	Oct.	3	20	11,412.50							3	20	13,775.00												
		24	250	$ 149,725.00	6	40	$ 26,800.00	4	110	$ 69,187.50	14	100	$ 68,375.00												

EXHIBIT 5-E, ANNEXED TO STIPULATION OF FACTS.

115

CORN PRODUCTS REFINING COMPANY

SALES OF CORN FUTURES CONTRACTS BY MONTHS YEARS 1938 THROUGH 1940

Year	Month	Number of Contracts	M. Bushels
1938	Jan.	—	—
	Feb.	—	—
	Mar.	49	1,500
	Apr.	28	475
	May	38	755
	June	55	1,250
	July	185	4,050
	Aug.	164	3,795
	Sept.	111	2,480
	Oct.	49	1,035
	Nov.	29	655
	Dec.	47	1,405
	Total	755	17,400
1939	Jan.	139	3,275
	Feb.	10	205
	Mar.	55	925
	Apr.	59	1,330
	May	—	—
	June	14	355
	July	26	1,265
	Aug.	68	3,035
	Sept.	51	1,230
	Oct.	27	375
	Nov.	62	1,275
	Dec.	24	910
	Total	535	14,180
1940	Jan.	56	1,405
	Feb.	17	410
	Mar.	12	360
	Apr.	92	2,390
	May	49	665
	June	104	1,845
	July	159	3,000
	Aug.	91	1,910
	Sept.	88	1,620
	Oct.	39	790
	Nov.	9	100
	Dec.	12	100
	Total	728	14,595

116

117

118 **Report of Proceedings.**

[SAME TITLE.]

70 East 45th Street,
New York, New York,
Tuesday, June 13, 1950.

(Met, pursuant to notice, at 11:10 a. m.)

BEFORE:

119 HON. J. EDGAR MURDOCK, *Judge.*

APPEARANCES:

JAY O. KRAMER, Esq., 10 East 40th Street, New York, N. Y., appearing on behalf of petitioner

SAMUEL MCCAIN, Esq., 17 Battery Place, New York, N. Y., appearing on behalf of petitioner

WALT MANDRY, Esq., (R. P. Hertzog, Division Counsel,
120 Bureau of Internal Revenue), appearing for the respondent.

PROCEEDINGS

The Clerk: Docket No. 20399, Corn Products Refining Co.

Mr. Kramer: J. O. Kramer, for the petitioner.

Mr. Mandry: Walt Mandry for the respondent.

Mr. Kramer: Petitioner is ready.

The Court: All right, you may proceed. I have read the petition in this case and from that I gather that the one issue relates to whether profits and losses for 1940,

which is the only year before the Court, profits and losses 121
on corn futures should be treated as capital gains and losses, or whether they are to be treated as ordinary income and ordinary losses.

The other issue has to do with, you claim, the Commissioner's understating the foreign tax credit. I get that much out of the pleadings.

Mr. Kramer: As to the latter issue, that is no longer a matter of dispute. The only problem there is the computation under Rule 50, after the correct income from domestic sources has been determined. I don't think there is any question.

The Court: That will iron itself out under Rule 50, if 122
I decide the first point.

Mr. Mandry: That is so stipulated in our stipulation.

Mr. Kramer: As your Honor has already indicated, this is a proceeding to determine the correct tax liability of the petitioner for the calendar year 1940. In his 90-day letter, the Commissioner has determined there was a tax deficiency of $163,804.78. On the other hand, the petitioner claims there is an overpayment. The dispute arises not out of any adjustments made in the 90-day letter, but out of the denial of refund claim by the respondent with respect to corn futures situation wherein the petitioner 123
claims that the transactions were capital transactions resulting in capital gains and capital losses and the respondent has taken the position that they resulted in ordinary income or regular business deductions.

I might point out that there was an additional item of $9,975.42 which has been added to net income since the 90-day letter was issued. We are stipulating to that. It arises out of an insurance refund from a previously deducted item and therefore that deduction is no longer in effect. That is contained in the stipulation. The case will be presented to the Court on a stipulation of facts which

124 will cover most of the mathematical problems involved here, plus the testimony of a series of witnesses.

The basic issue has already been stated and that is whether capital gains and capital losses. There is a further issue, however, and that is whether the wash sales provisions applies to these types of transactions, Section 118. We will offer some testimony on that score as well.

I would like to outline for the Court very briefly the general background of this picture. The petitioner is probably the largest user of raw corn in the United States. It is in the business of manufacturing corn derivatives
125 from raw corn, including starches, cerelose, which is a corn sugar, oils, feed; feed and oils are byproducts. It does not and has not sold raw corn. It is not in the business of buying raw corn and selling it.

Starting in 1932 the company, for reasons which will be explained by the witnesses, commenced to purchase futures contracts on the Chicago Board of Trade. In other words, it commenced to establish a long position in futures contracts. This position was gradually increased during the years.

As your Honor is aware, the farm belt suffered severe droughts during the years 1934 and 1936. This had a
126 striking effect on the entire picture as faced by petitioner. One of petitioner's products, his sugar, is derived from corn. It competes with cane and beet sugar. The petitioner found itself in 1937, because of the tremendous rise in the price of corn, due to the droughts, with this situation: it was selling its cerelose at a loss. Its cost was too high. It could not compete with cane sugar on an equal basis because of the rise of corn due to the droughts.

At that point the petitioner decided to expand its corn futures' position. There will be testimony as to the size of the anticipated position which would be taken to fix the cost of cerelose, as nearly as may be.

Now, that program was anticipated by the commence-

ment of buying a substantial amount of corn futures in 1937, above and beyond what had been previously purchased in early years. 127

Unfortunately, from petitioner's point of view, a dispute arose with the commodities exchange authority as to the size of that position. We will show by competent testimony what that dispute was and what the outcome of it was. It is sufficient for the purposes of the opening statement to merely state that an agreement was reached with the commodities exchange people as to the size of that position and as to the manner of reporting our weekly position to the commodity exchange people. It will be pointed out that it was more economical for the petitioner 128 to purchase futures contracts rather than to try and buy raw corn in excessive quantities.

The annual grind of petitioner during 1940 was approximately 37 million bushels and was approximately 35, 36 million bushels in the two previous years respectively. It has been stipulated that the raw corn storage capacity of the petitioner in the year 1940 was approximately 2,300,000 bushels. That should be taken against the figure of 37 million being the annual grind. It was impractical from a monetary point of view to buy the difference in raw corn, even if it were available, and store it in elevators. Consequently, it was found that by buying futures, the company 129 could assure itself in the future when it required delivery, that it could obtain raw corn on the maturity of the corn futures contracts.

The stipulation will indicate that a large percentage of these corn futures contracts were carried out; delivery was taken on the corn itself. This was not speculation, where the position was taken merely for a speculative profit. Actual delivery was taken on occasion.

I would like briefly to discuss or to mention the position with respect to hedging because there is the issue in the case. Petitioner does not want to turn this trial into a

130 lecture on semantics. We are going to define hedging as the Tax Court has done and as the Circuit Court of Appeals has done and as the Commissioner has done in the General Counsel's memorandum, to constitute only one of two things. A hedge, technically, is either a short sale against inventory, according to the Tax Court's definition, or secondly, is the establishment of a long-term futures position against forward sales commitments. I believe we can narrow the issues in this case to the latter part of the definition.

I don't believe that respondent is contending that petitioner was hedging in the form of short sales against
131 inventory. We have no evidence of any such short sales in this case so far as I can find. So this trial should mainly confine itself to whether the futures contracts position which petitioner established during these years was a hedge against forward sales commitments. That necessitates a study of what the forward sales policy of this company was. We will produce certain witnesses who will testify that the policy of the company with respect to the forward sales was not to commit the company beyond 30 days whereas the futures contracts may run as much as nine months.

132 Furthermore, we will show that even when the company committed itself to 30 days forward sales, the buyer obtained not the price at the date of contract, but the price at the date of delivery, so that the inference being that as of the date of the contract the price was unknown, the final price was unknown to the seller and consequently it was mathematically impossible for him to hedge against that price.

There were certain minor exceptions to this sales policy which will also be brought out by witnesses. They had to do with two factors, the canning industry on the Pacific Coast and an offer which was made on January 15, 1940, in the cerelose industry, or to users of cerelose. I wanted

to explain very briefly what they were so the Court will understand what the witnesses will testify to. 133

An offer was made to the canning industry on the West Coast whereby the company guaranteed to the industry to deliver a certain quantity of cerelose, which is corn sugar, at a price which would be the better of two prices, either the date of contract or the date when they ordered out the merchandise. The quantity was at the option of the purchaser. The price was as of the date of arrival or delivery and consequently it was again mathematically impossible to hedge against that situation since it was not known what percentage of the contract the buyers would take. We will show, for example, that in the year 1940 approximately 60 percent of these so-called contracts were canceled, were not carried out by the purchaser. Consequently, your Honor will realize the difficulties under which petitioner would have been had it tried to hedge. 134

The second exception to the general rule had to do with a certain offer made in the cerelose situation on January 15, 1940, and again the buyer was given the same privileges. It was an option on the part of the buyer to take up to a certain amount for a period up through June 30, 1940, a certain monthly amount and if he didn't take it, the balance was canceled. The price again was fixed as of the date of arrival or delivery and consequently it is petitioner's contention that there was no hedging there. 135

Now there is a third situation which I think we ought to mention, although it is not an exception to the general sales policy. It is something entirely apart and that is the situation involving the Keever and Huron contracts. A long time prior to this period, the company entered into two agreements, one with the Keever people and the other with the Huron milling people, whereby the company agreed that it would do custom milling for those two customers at a fixed price. This price was arrived at by ascertaining the price of corn, the cost of labor and so on.

136 In other words, the profit of the company was already fixed in advance on that. It was a custom milling job and consequently there was no occasion for this petitioner to hedge against a situation. It was merely performing a service for these two mills.

Consequently, it is petitioner's position that these two contracts do not affect the situation in any manner.

Among the exhibits which we will offer will be a graph which will show, we believe, quite a specifically what the total futures position of petitioner was at any moment during any of the years involved.

137 When I say "any of the years involved," I mean from 1938 through to 1941. The reason I say years are involved, although the tax year is 1940, the wash sales positions carry back into 1938 and the futures purchased in 1940 are executed in 1941. This graph will show that there was no correlation, we believe, between the sales program of petitioner and its futures position.

Mr. Mandry: May it please the Court, in view of the general statement that Mr. Kramer has made, I am quite sure your Honor is familiar with the general background of this case. So I will state merely the respondent's position.

138 It is the respondent's position that an operating company, such as this, that had to assure itself of a supply of corn in the future and constantly from month to month, because the storage supply was only about three weeks, that it was necessary for them to prevent a possible business loss to be assured at all times that they would have an ample supply of corn in the future and it is our contention that this is a hedge against that loss or is a business deduction and therefore not within the ambit of Section 117.

Our position is, as a subhead, and that is as Mr. Kramer has explained, that there were certain forward sales, and I suppose the exact nature of those will depend a great

deal on the evidence. Certainly, to the extent that they 139
were forward sales, any purchase against those would, I believe, come within what Mr. Kramer's own definition of hedging is.

The other point is whether the wash sales provisions apply. It is our contention that the word "securities" as used in that section does not embrace futures contracts of this kind. I think that is sufficient.

The Court: I have listened and read, but I am not sure I am with you even yet. Let us take up wash sales proposition first. Mathematically how does that work out; that the petitioner wants to disregard certain transactions be- 140
cause they came in within the wash sales position, is that it?

Mr. Kramer: If petitioner has a loss in a previous year and within the 30-day period, either before or after, acquired a substantially similar contract, we claim that that loss must be disallowed and added to bases for future years.

In other words, that carries on through the years.

The Court: In other words, what you regard as wash sales in prior years disregarded, you will get a larger deduction in the tax year?

Mr. Kramer: We will have a higher basis in the tax 141
year.

The Court: In a larger loss or smaller profit?

Mr. Kramer: That is correct.

The Court: In the tax year do you have a net profit from these transactions or net loss?

Mr. Kramer: During the tax year, without the provisions of Section 118, we have a profit.

The Court: In other words, the net result of your operations in this particular field during the tax year resulted in a plus figure instead of a minus figure.

Mr. Kramer: That is right. That is all covered in the stipulation.

The Court: I understand. I just wanted myself straight-

142 ened out so that there isn't something here that I don't understand.

Mr. Mandry: I may add, although it is in the stipulation, that the taxpayer in the taxable year, as Mr. Kramer stated, in effect reported the net profit as an ordinary income and it has consistently done that in all prior years.

The Court: And also that the adjustment wasn't made in the notice of deficiency but you are asking for it nevertheless?

Mr. Kramer: I would like to point out that the taxpayer has consistently kept its books and records and we will have a witness testify to that effect, whereby these
143 transactions were applied to cost of goods sold. However, in the years following 1940, the Commissioner took a number of cases to the Tax Court and other Courts, contending that these transactions were capital transactions where the taxpayers were claiming to have ordinary losses.

Consequently, seeing those decisions, this taxpayer decided if they were capital transactions for those taxpayers' purposes, they were capital transactions for ours.

The Court: I suppose I have to decide it no matter how it happened to arise anyway.

We will recess for five minutes.

144 (Short recess taken.).

The Court: You may proceed.

Mr. Kramer: If it please the Court, through Mr. Mandry's kind cooperation, we have arrived at a substantial stipulation of facts here which we would now like to offer.

The Court: The stipulation may be received.

Mr. Kramer: Attached to the stipulation are five exhibits running from 1-A through 5-E, inclusive.

At Mr. Mandry's request, two additional schedules were prepared subsequent to the preparation of the stipulation, showing a weekly analysis of the stock on hand of petitioner from July 1, 1938, to the end of the year 1940. This is broken down into two separate schedules, one having to

do with the cerelose bulk and package sales of petitioner and the other having to do with the feed or byproducts of petitioner. 145

With the Court's permission, we would like to offer these two schedules as one exhibit in evidence as 6-F.

The Court: They are admitted.

(Whereupon, the documents were received in evidence as Joint Exhibit 6-F.)

Mr. Kramer: Since the preparation of the stipulation of facts, petitioner has prepared a graph running from the year 1938 through the year 1941, showing the long position of petitioner at any given time as against the so-called sales commitments. This makes graphic what has previously been stipulated to in the other exhibits. 146

Mr. Mandry: No objection.

The Court: It is admitted.

(Whereupon, the document was received in evidence as Joint Exhibit 7-G.)

Mr. Kramer: At this time I would like to call Mr. Praeger.

Whereupon, 147

ALWIN H. PRAEGER

was called as a witness on behalf of the petitioner, and having been first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Kramer:

Q. State your name and address for the record. A. Alwyn H. Praeger, 425 Second Street, Oradell.

148 Q. What is your present employment? A. I am director of purchases for Corn Products Refining Co.

Q. How long have you been employed by the petitioner? A. Well, this November 10 I will have been employed 40 years.

Q. What was your position with the company during the period from 1936 to 1940? A. I was assistant to Mr. Campbell. I was probably general purchasing agent at that time.

Q. Mr. Campbell is here in Court today? A. He is.

Q. What were your specific duties at that time? A.
149 We were directing and supervising all of the purchases of the company including corn.

Q. Now, to your knowledge, when did the program of purchasing corn futures commence? A. Well, we started in, I think, 1932, the early part of 1932.

Q. What was the volume at that time compared to later days? A. It probably ran 3 to 5 million bushels at one time until 1937 when we stepped up our purchases.

Q. What was behind the corn program? Why did you buy corn futures at that time? A. In 1937 you are referring to?

Q. No, in the previous period. A. Well, in 1932 up to
150 1937, it was just part of our general corn program, where we held a greater or lesser amount, depending on the price of corn at a given time.

Q. Not to lead you too much, but if you found that corn was cheap, you would buy corn futures? A. That is correct.

Q. It has already been made part of the stipulation that the storage capacity of petitioner during the year 1940 and we assume during early years, was approximately was 2,300,000 bushels. A. That is right.

Q. Could you have stored corn outside of the company's elevators? A. We could have, yes.

Q. You could have purchased and done so? A. Yes.

Q. Would that have been expensive? A. That would 151
have been very expensive.

Q. Will you explain in what way it would have been expensive? A. Well, in the first place we would have a warehouse charge which amounts to about a cent and a half a month and there may be—is there an elevator charge—I am not sure whether there is an elevator charge to that or not, but depending upon the time we would have corn in storage, it may cost us five or ten cents a bushel more.

Q. Where would you have obtained the financing for such a program? A. We get it right out of our treasury.

Q. It has been stipulated that during the year 1940 the 152
corn used by the company ran to about 37 million bushels. What would have happened had you tried to finance that all at one time? A. That would have been a tremendous job.

Q. Exactly. Then your testimony is that it was more practical to purchase corn futures rather than to buy raw corn and store it outside of the company's warehouses? A. That is correct.

Q. Do you recall the droughts of 1934 and 1936? A. I do.

Q. What was their effect on the price of corn? A. Well, 153
it increased the price of corn materially.

Q. Are you familiar with the product of the company known as cerelose? A. Yes, sir.

Q. What is cerelose? A. Cerelose is a sugar derived from corn.

Q. What are the products on the market with which it competes? A. Cane and beet sugar.

Q. Now, did the droughts of 1934 and 1936 affect the competitive position of cerelose? A. It certainly did. It increased our manufacturing cost to the extent that we were losing money on each sale of sugar.

Q. Of cerelose sugar? A. Of cerelose sugar.

154 Q. Did the company take steps thereafter to protect itself against that situation? A. We attempted to protect ourselves by establishing a policy of accumulating some 12 million bushels of futures contracts. It was our original intention at the time to accumulate this amount until about June or July and by that time, if there were no indications of a short crop of corn, we would liquidate our position and start in accumulating again during harvest time. If there was a short crop, we would liquidate them gradually with the manufacture of sugar each day or week.

Q. Did anything happen which interfered with that program as you have outlined it? A. Well, it took us from 155 the fall of 1937 through practically all of 1938 before we had accumulated our position and we had a little interference in the commodity exchange ruling. I think that happened in July of 1938.

Q. When you say you had "a little interference," what do you mean? A. I mean that—I don't recall the number of the bill—but the essence of it was that we were permitted to have only 2 million bushels over and above our sales commitments.

Q. What happened in 1939? A. Well, in 1939, the war came on and we changed our program at that time. We 156 didn't feel as though we needed this protection. While the price of corn increased materially, so did the price of sugar. There were also no indications of a shortage of crops in that year, so we liquidated our position in 1940.

Q. I show you a Joint Exhibit 7-G. Will you indicate to the Court on that exhibit the liquidation of this position during the year 1940? A. Well, in February of 1940 we held a position close to 8 million bushels. There was a gradual liquidation from March through to September. We wound up the year with a long position of 2½ million bushels. Wait, this is orders. I am sorry. We wound the year up with a half million bushels, long position.

Q. In other words, you liquidated from 8 million to less

than a half million? A. Less than a half million in 1940. 157

Q. Will you repeat what the cause of that liquidation was so that we can have it made completely clear? A. I don't quite get your question.

Q. Will you repeat to the Court what the basis for that liquidation was?

The Court: I understood him the first time.

Mr. Kramer: I am sorry. I didn't know whether he made himself completely clear. I withdraw the question.

Q. Now, at all times during the years 1938 to 1940, did 158 the company have a long position in corn futures? A. Yes, they did.

Q. At that time, or during that period, did the company make any short sales of corn futures? A. No, they did not.

Q. Was the company thereby taking the risk of a drop in the price of corn? A. There was always that risk.

Q. Did this program which you outlined work to the company's advantage as far as you know? A. No.

Q. What happened? A. Well, I am not sure which year —I think we did show a profit in one of those years, but on the whole there is a definite expense. 159

Q. During those particular years? A. Particularly in 1937, I think it was.

Q. I think the stipulation of facts will show that. Are you familiar with the sales policy of the company? A. Just in a general way. Mr. Mueller is here. He can testify to that.

Q. Did you prepare weekly reports of the company's long position during this period for the commodity exchange authority? A. Yes, we did.

Q. What is the bushel amount of a corn futures contract? A. 5,000 bushels.

160 Q. Do you know what the months are, the contract months of maturity on such a contract? A. The most active months are May, July and December; occasionally March and October.

Q. Confining yourself to the year 1940, do you remember what the months were in that particular year? A. No, I do not. I am not sure whether we traded in March or not.

Mr. Kramer: That is all.

CROSS EXAMINATION

161

By Mr. Mandry:

Q. Mr. Praeger, I believe you stated that in 1932 to 1937 you commenced buying corn futures. A. That is right.

Q. And because of the drought of 1934 and 1936 there were increased prices in raw corn, was there not? A. That is right.

Q. What were you buying these futures to protect? A. The 1937 program.

Q. In 1937 and running up to 1938-39 and 1940? A. We were trying to protect a part of our manufacturing costs.

162 Q. Well, now, you spoke of 1939, because of the war; what war were you referring to? A. World War II.

Q. That didn't start until somewheres later on, so far as the United States is concerned? A. That is right.

Q. What effect did that have on the corn situation in the United States?

The Court: You mean from 1939 to December, 1941?

Mr. Mandry: Yes, your Honor.

A. Well, it eventually increased the price of corn and likewise the price of sugar.

Q. So you have the same reason for buying futures during that period as you did during the period in 1934 to 1936? A. No, in 1939 it was decided that we didn't need that protection. I mentioned that by July of 1939 there were no indications of a short crop. It was also a costly proposition to maintain a long position such as we have had by carrying the futures contracts over from one period to the other and we didn't feel that we should spend that money for that protection. 163

Q. In other words, you were willing to run the risk you thought at that time without buying corn futures? A. That is right.

Q. Now, on Exhibit 7-G, looking at the year 1940, I believe you stated your long position went from 8 million bushels at the beginning of the year to one-half million bushels at the end of the year. A. That is right. 164

Q. Will you look at that exhibit again. What was the amount at the end of the year?

The Court: Of course, the exhibit will show that.

A. It is a million four, Mr. Mandry.

Mr. Mandry: The figures are rather tiny down there. That is true, your Honor, except that the figures are rather tiny down there. 165

Q. You stated that the company never had any short position? A. That is correct.

Q. How did you close out the purchase contracts when you decided not to take the grain and call for it? A. We would sell them at market prices.

Q. You sold what? A. The futures contracts.

Q. Didn't you enter into another contract to sell corn at that time for future delivery or for the same contract months? A. To sell corn, no, sir. We would liquidate our

166 position by selling our long position. In that sense, we were selling it, yes.

The Court: In other words, you had a contract for futures and you gave that contract to somebody else and they paid you for it?

The Witness: That is correct.

Q. You mean to say that when you had a contract to buy corn for December delivery and some time prior to the delivery date, that you actually went out and sold that contract that you had to someone else, is that what you
167 mean to say? A. That is correct.

Q. Are you familiar with the mechanics whereby that is performed? A. No, I am not.

Q. So you are just speaking in terms of the trade when you say you sold a futures contract? A. That is right, sir.

Q. Mr. Praeger, starting out with a bushel of corn, that is 56 pounds, is it not? A. Right.

Q. Can you tell us in pounds the derivatives that you derive from a bushel of corn? A. Well, from a bushel of corn, no, I don't have those figures in my mind, sir.

168 Mr. Kramer: Can you do it on the basis of 100 pounds?

The Witness: 100 pounds, dry basis, I think the starch would be about 62 or 63 percent. Your feed would be around 33 percent. Oil about, well, the difference there, about 3 or 4 percent.

Q. What do you include in the term "feed"? You said "feed." A. Feed and meal, which is a byproduct of our manufacture, and consists of the hulls of the corn and other properties that aren't used in starch or oil.

Q. And that term would include gluten meal? A. Yes, sir.

Mr. Mandry: That is all, Mr. Praeger. 169

The Court: Any further questions?

Mr. Kramer: I just want to ask the witness one question.

RE-DIRECT EXAMINATION

By Mr. Kramer:

Q. Mr. Praeger, did you have this schedule prepared for me for the year 1940? A. You want me to recite this?

Q. Do you recall having this prepared? A. No, I do not recall, personally. 170

Mr. Kramer: No further questions.

RE-CROSS EXAMINATION

By Mr. Mandry:

Q. Mr. Praeger, your company is required to file certain reports with the Department of Agriculture and commodity exchange authority, are you not? A. That is right.

Q. You mentioned something on direct examination that you had a little, I believe you used the word "interference" in 1938. What was that interference that you were referring to? A. If I remember the ruling, it restricted us from having a long position greater than 2 million bushels over our sales commitments. 171

Q. The commodity exchange act provides for that itself, don't you know? A. That I don't know. I am not a lawyer.

Q. Doesn't the act say that you can't have a long position over 2 million? A. I don't know.

Q. What was the trouble you had with the commodity exchange? A. Well, it developed into conference be-

172 tween our attorneys and the commodity exchange. It was just that uncertainty during that time, that we weren't sure of our position and until it was cleared up, why, we were at a loss to know where we were permitted to go.

Q. Did the commodity exchange think you had a long position beyond the trading allowance? A. They did at first, but I am sure our attorneys straightened them out on it.

Q. How did you convince them that you didn't? A. Our attorneys handled the case, sir, and I wasn't sure.

Q. Did you also have some, shall we call it interference in 1940 with respect to your 1939 position? A. I don't
173 recall that, sir.

Q. Well, as a matter of fact, apparently you are not very familiar with what did happen there. A. No, it was handled by our attorneys.

Q. I will ask you one more question. When you were speaking about protecting from losses, was your company in the business of speculating and buying and selling corn futures? A. No, sir.

Mr. Mandry: That is all.

RE-DIRECT EXAMINATION

174

By Mr. McCain:

Q. Mr. Praeger, of course I am quite cognizant that you didn't handle the legal details of this CEA investigation by the Department of Agriculture. The commodity exchange authority at that time was a part of the Department of Agriculture. However, let me refresh your recollection. I think you did prepare and file the reports with the commodity exchange authority? A. Yes, sir.

Q. As a matter of fact, I have here a schedule that you prepared before Mr. Frank Hall who did handle this

matter and I would like to hand you this schedule and 175
one of the commodity exchange act forms and get you to explain just how these were prepared.

Mr. McCain: I think, your Honor, that possibly the thing to do is put in one of these blank forms as an exhibit for the record.

The Court: You have me at a disadvantage at the moment because I don't see any appearance entered for you.

Mr. McCain: It is entered, your Honor. My name is Samuel McClain.

The Court: The file I have doesn't show any- 176
body but Mr. Kramer.

Mr. Kramer: Mr. McCain noted his appearance on the call of the calendar and again at the beginning of this case. If Mr. Mandry will consent, I would like to offer in evidence as an exhibit forms of the commodity exchange authority, No. 204. There are two forms.

Mr. Mandry: No objection, your Honor.

The Court: It is admitted.

(Whereupon, the documents were received in evi- 177
dence as Petitioner's Exhibit 8.)

Mr. McCain: I suggest that that might be handed to the Judge so he can follow the testimony.

By Mr. McCain:

Q. Now, Mr. Praeger, I would like for you to look at this form you prepared December 8, 1939, and explain just how you arrived at the figure that was put under each column. I don't think we are so much interested in the exact figure on any one of these reports as the method of

178 preparation and I suggest you might take from your summary sheet and follow across with that on one of the forms.

Q. In column 3 of this form, we show our corn position, the corn we have paid for and have in our tanks. In column No. 4 we show our filled stock of products that have not been sold. In column No. 9 is the total of our corn stocks and filled stocks. Column No. 11, our sales commitments, those which are on our books at that time. By deducting your long position of corn and products from your sales commitments, we have a net short position shown in column 2. Net is our position of the various
179 futures contracts which, in this particular case, adds up to 8 million bushels.

Q. Now, Mr. Praeger, I would like for you to explain the numbered columns on here and you have entered in various places or under the instructions had to enter a position as one of three things, I believe, either speculative, spreading, or hedging. Will you explain the reason you followed in making the entries on these forms? A. Well, neither one of the headings would cover the operations as I see it. It definitely wasn't a speculative operation nor was it a spreading operation. So we had no
180 choice but to put it under the hedging column.

The Court: What do you describe as a "hedging column"?

Mr. McCain: I think if you turn that over, your Honor, it says you have to designate the instructions.

The Court: Any further questions?

Mr. McCain: Yes, just one or two more, your Honor.

Q. You felt that you did not fit under the speculative classification, not because you considered that you had a

real hedge, but because you considered that you were doing something in the way of protecting a business risk, is that correct? A. That is right. 181

Mr. McCain: That is a little bit leading, Mr. Mandry; I apologize.

Q. The commodity exchange authority on the other hand, I believe, took the position that you were not entitled to take this long position which you would have been allowed to do if it had been hedging, is that according to your recollection? A. Yes, I think that is correct. 182

Mr. McCain: I think that is all, your Honor. Mr. Hall, who handled the legal end of it with the commodity exchange authority is in Court and we can put him on to explain this.

The Court: Were your questions directed to explain the fact that they showed a net short position?

Mr. McCain: No. Mr. Mandry has pointed out in the records that this long position was reported as hedging.

The Court: That is what I don't understand. You say it was reported as hedging, but looking at the form I don't understand why you say that. There is nothing on the front of the form that mentions the word "hedging" that I see. 183

Mr. Kramer: Does your Honor have the long or vertical sheet there?

The Court: Go ahead.

Mr. McCain: I think that Mr. Mandry's point, your Honor, is that these positions were entered in the column "hedging" and the purpose of this testimony is to show that that was the only place that Mr. Praeger, in making out his form, could put

184 these transactions since he did not consider them speculative.

The Court: My question isn't important any more. The form I had didn't show that.

Mr. McCain: One was a daily report and the other a weekly report. No further questions.

Mr. Mandry: No further questions.

The Court: The witness is excused.

(Witness excused.)

Mr. Kramer: Mr. Campbell, please.

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185 D

Whereupon,

CLARENCE L. CAMPBELL,

was called as a witness on behalf of the petitioner, and having been first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Kramer:

186 Q. Will you state your name and address for the record? A. Clarence L. Campbell, Greenwich, Connecticut.

Q. Mr. Campbell, what is your present occupation? A. Vice-president and director of the Corn Products.

Q. And how long have you been associated with the company? A. 44 years next month.

Q. During the period from 1936 to 1940, what was your position? A. Well, I was actively in charge of trying to guide the purchases and the policies connected with raw materials.

Q. Was Mr. Praeger, the previous witness, your assistant in that? A. He was.

Q. Now, for the purpose of shortening this trial, if your Honor will accept, and Mr. Mandry will accept, I would like to ask the witness just one question. 187

You have heard Mr. Praeger testify and if the same questions were asked of you, would you testify substantially as he testified? A. Yes.

Mr. Kramer: That is all.

Cross Examination

By Mr. Mandry:

188

Q. Mr. Campbell, you have also heard Mr. Praeger testify on cross-examination that the company was not engaged in speculative practices. Do you agree with that? A. I do.

Q. And that the purchase of corn futures was made to protect the business from loss. Do you agree with that? A. It was made to protect the cost of the raw material that was used for making cerelose sugar. Cerelose sugar is sold in competition with beet and cane sugar, the prices of which are absolutely independent of the prices of corn.

Q. That would be true of some other products, wouldn't it, such as starch? A. Well, I don't think starch would 189 compete with sugar.

Q. But starch competes with starch of other companies, does it not? A. Yes, indeed.

Mr. Mandry: That is all, Mr. Campbell.

Re-direct Examination

By Mr. McCain:

Q. Mr. Campbell, I think the point you were making, which Mr. Mandry and the Court misunderstood, was that

190 cerelose is sold at a differential under cane and beet sugar. Now, Mr. Mandry asked you if the company's starch was not sold in competition with the products of other companies and you answered "yes" which is quite correct. However, you did not intend to give the impression that the price of starch did not fluctuate with the price of corn itself, did you? A. Why certainly it does.

Q. It does fluctuate with the price of corn itself? A. Yes.

Mr. McCain: That is all. I just wanted to clear that up.

191 Mr. Mandry: That is all.

The Court: Witness excused.

(Witness excused.)

Mr. Kramer: Mr. Mueller, please.

Whereupon,

FRED MUELLER

was called as a witness on behalf of the petitioner, and
192 having been first duly sworn, testified as follows:

The Clerk: State your name and address for the record.

The Witness: Fred Mueller, 514 Ridgewood Avenue, Glen Ridge, New Jersey.

DIRECT EXAMINATION

By Mr. Kramer:

Q. What is your present employment? A. Practically retired. However, I am on a consulting basis with Corn Products Refining Co.

Q. When were you first employed by Corn Products? 193
A. 1902, May.

Q. And you were with the company how long until your present retirement? A. 45 years.

Q. You were with the company then during the period 1936 to 1940? A. I was.

Q. What was your then capacity? A. I was manager of bulk sales.

Q. And at the time of your retirement, what was your capacity? A. I was president of the Corn Products Sales Company and general manager of all sales.

Q. You are familiar with the products produced by the company? A. I am. 194

Q. Will you tell the Court roughly what categories they fall into? A. You want me to enumerate our different products?

Q. Not by trade name, but in general categories. If I may lead you for a moment, starches— A. Corn syrups, starches, sugars and cerelose, which is a refined sugar. Do you want the other byproducts made from starches, like dextrin?

Q. To shorten the period of examination, will you classify starches and sugars as the main products and feeds as byproducts? A. That is correct. Starch and corn 195
syrup, which is package syrup, are the main products. Cerelose sugar, which is a refined sugar, is included in the main products. Feed and oil are byproducts.

Q. Do you know the approximate dollar value to be obtained from those general categories? Does the list refresh your recollection for the year 1940? A. Well, I didn't make up these figures, but they do look correct.

Q. Will you state what the correct figures would be, then, in your opinion? A. I say they look correct.

Q. Will you explain to the Court the dollar value of the various products of the company as shown in this memo-

196 randum which you now hold? A. Will you repeat that, please?

Q. Will you explain to the Court the comparative dollar value between the products of the company? A. Well, I don't have that. Yearly average yields, all plants, from commercial corn, No. 2 basis, their values at prices prevailing July 1, Chicago basis—this is 1940—pearl starch in bags, 63.31, will be at $2.80; a hundred pounds equals $1.773. Gluten in bulk 27.13 pounds at $18 a ton, equals 2.44. Oil, 3.14 pounds, at $5 per hundred pounds, .157. Yearly average cost of corn, No. 2 basis, Argo, 100 pounds, $1.126. All plants per hundred pounds, $1.115. Comparative yields, Argo plant only, starch 63.22 pounds, feeds 27.23 pounds, oil 3.13 pounds.

197

Q. In other words, starch was not only the major yield from corn in point of view of content but also in point of dollar sales volume per hundred pounds. Do you understand my question? A. I don't quite get you and I don't have the figure on that.

Q. In other words of any given quantity you just testified that $1.77 went toward the purchase of the starch by the consumer, 24 cents would have gone towards the feed and 15 cents towards the purchase of oil obtained from the raw product? A. That is right. That is the yield you are talking about?

198

Q. That is right. A. Starch, of course, is used in making the other products like corn syrup and cerelose.

Mr. McCain: I think I might just clear Mr. Mueller up on this. We were asking him when he was in the office the value of the products derived from 100 pounds of corn and you gave instructions that this memorandum be prepared. You didn't know offhand. I don't think you realize that this is what this was.

The Witness: That is right, I did not.

Mr. McCain: But that is what it is, the value of 199
the products of 100 pounds of raw corn. So the yield figures times the price would give you the price of those products.

Mr. Kramer: I would like to offer in evidence the memorandum which was prepared, and ask your Honor for permission to withdraw it and make a photostat.

Mr. Mandry: No objection.

The Court: It is admitted.

(Whereupon, the document was received in evi- 200
dence as Petitioner's Exhibit 9.)

By Mr. Kramer:

Q. During the period 1936 to 1940, were you familiar with the sales policy of the company with respect to bulk products? A. Yes, I was the manager of bulk sales.

Q. And what was that policy? A. Our policy was to sell for shipment within 30 days; the orders would cover a price but guaranteed against decline on date of arrival. In other words, the buyer was protected as far as the price was concerned but if there was a decline before the goods arrived, he would get the benefit of it. 201

Q. Did you bring with you a form, a standard form of contract used during that period? A. Yes, I did. Here it is.

Mr. Kramer: I would like to offer in evidence, as Petitioner's Exhibit 10, a photostatic copy of such standard contract.

Mr. Mandry: No objection.

The Court: It is admitted.

(Whereupon, the document was received in evidence as Petitioner's Exhibit 10.)

202 By Mr. Kramer:

Q. A moment ago, Mr. Mueller, you referred to a guarantee against price decline between the date of the contract and the date of delivery. Are you referring specifically to the next to the last paragraph in the previous exhibit? A. Correct.

Q. Now, were there any exceptions to this general policy of not committing the company to sell beyond 30 days? A. Yes, we had two instances.

Q. And what were those instances? A. I have a wire here which we sent out to our trade on January 15. May
203 I read it?

Q. Will you read it? What year was that? A. January 15, 1940. "Until close of business January 20 will accept orders for cerelose, figures at today's market price, for shipment to June 30. Price guaranteed against our decline to date of arrival. Shipments to be made in as nearly equal monthly quantities as possible and must not exceed 25 percent of the total amount of contract in any one calendar month. Any unspecified portion for any calendar monthly installment will be automatically canceled. All business subject to confirmation from this
204 office."

Q. And following that program, following that telegram, did you receive a substantial amount of orders? A. Yes, we booked quite a bit of orders.

Q. Did you permit the buyers to cancel any portion not taken in any given months, in accordance with the provisions? A. Yes. There were cancelations.

Q. Would you care to indicate on chart known as Exhibit 7-G, what happened when that telegram was sent out? A. There were considerable bookings between January 15 and 20.

Mr. Kramer: May I read from Exhibit 7-G? It indicates that during this period, from January 15

to the end of the month, your sales rose from 2 million bushels to almost 8 million bushels. 205

A. The sales on cerelose at that particular time ran up to about 2 million bags.

Q. Now, you mentioned that there was another exception. A. Yes, that was with the canning trade out on the Pacific Coast.

Q. What was your arrangement with the canning trade on the Pacific Coast? A. In 1939—may I read this contract? I think it will give all the facts.

Q. Read whatever clause you think is necessary. A. "Deliveries required to September 30, 1939, balance unshipped on September 30, 1939, will be canceled. The goods covered by this contract are to be used exclusively in your own plant or those under your control for canning or preserving purposes. If our regular market price and your market price is lower than price herein specified on date of arrival, buyer will be entitled to such low price. Goods covered by this confirmation are merchandise under letters patent and sold for consumption in the United States of America only." 206

Q. In other words, as far as the canning industry was concerned, you gave them an option to require delivery up to a certain amount and if they didn't call on you for delivery, that amount was canceled, the amount unordered out was canceled? A. That is correct. In fact, in 1939 we booked 281,908 bags. The cancelations amounted to 11.1 percent. 207

Q. What happened in 1940? A. In 1940 we booked 392,820 bags. The cancelations were 62.1 percent.

Q. 62 percent of these so-called orders were actually canceled? A. That is right.

Q. Do you recall offhand what the percentage of cerelose sales to total sales of the company were in 1940? A. 1940, 15 percent; 15.93 percent.

208 Q. Was the general policy then of the company at all times to take the risk of a decline in price from the date of contract to the date of delivery? A. It was always our policy, yes.

Mr. Kramer: That is all.

Cross Examination

By Mr. Mandry:

Q. Mr. Mueller, you being familiar with the sales poli-
209 cies, was your company buying futures and closing them out on speculation? A. I know nothing about the corn buying. All our work was in connection with sales.

Q. All you know is to the sales? Now then, why did you make a statement right at the end of direct examination that it was the general policy of the company to take the risk in declined prices? A. That is right.

The Court: He means on manufactured products.

The Witness: On the product we sold.

Q. On the product you sold. You being with the com-
210 pany 42 years, you were well aware that they were buying futures contracts during all of that period, say 1934 to 1940 inclusive? A. I was not aware of it.

Q. You never had any idea what the company was buying in futures? A. I had no idea what they were doing in the corn market.

Q. Do you know whether they were buying corn futures? A. No, I did not know they were buying corn futures.

Q. Then, if you didn't know that, then you didn't know whether the company was assuming the risk of declining prices or not, did you? A. Yes, sure, we were assuming the risk.

The Court: Aren't you arguing with him about something that you can argue with me, Mr. Mandry? He is only talking about the manufactured products. 211

Now, if you think that because of the futures they weren't assuming the risk, apparently, you are not going to get anything out of that witness that is beneficial. You can argue that to me regardless of what he says.

Mr. Mandry: I want to get his lack of knowledge to reflect upon his opinion that they were not assuming the risk.

The Court: I don't think it is a question of his opinion. He is talking about the manufactured products and how they dealt with his products. He is telling the absolute truth. 212

Mr. Mandry: I agree with you, your Honor.

The Court: And there is no doubt about it, he is telling the absolute truth.

Mr. Mandry: That is all.

(Witness excused)

Mr. Kramer: Mr. Hall, please.

213

Whereupon,

FRANK H. HALL

was called as a witness on behalf of the petitioner, and having been first duly sworn, testified as follows:

The Clerk: State your name and address for the record, please.

The Witness: Frank H. Hall, 256 Lydecker, Englewood, New Jersey.

214 DIRECT EXAMINATION

By Mr. McCain:

Q. Mr. Hall, what is your profession, sir? A. Member of the Bar.

Q. What was the date of your admission to the Bar? A. 1895, in New Jersey.

Q. And you have been the general counsel, vice president of Corn Products Refining Co. for how long? A. Well, I was in the firm of Steele, Otis & Hall, counsel for the Corn Products Refining Co. at the time of its organization in 1906. About 1920 I personally became the general counsel for the company. My recollection is I became a director in 1915 and vice president somewhere around 1938 or 1939. I don't remember.

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Q. Now, sir, I just wanted at this time to clear up some questions that Mr. Mandry had about this Commodity Exchange proceeding and I have the benefit of your recollection. I understand you have been over the file on this matter and could you tell us just in a couple of minutes what really happened and what the end of it was at this dispute with the Commodity Exchange authority. A. What I have seen in the file, in an effort to refresh my recollection of what took place around 1940, which I believe was primarily concerned with the futures transactions of grain, the last part of 1939. We were then charged, a formal complaint by the Commodity Exchange Commission with being long in excess of two million, having over two million bushels of corn, not required, as I remember, for spreading or hedging purposes. It is my recollection at that time, the meat of that complaint was that we were speculating in grain in excess of the amounts permitted under the statute and the matter proceeded to hearing.

216

Testimony was taken and subsequently the complaint was withdrawn; the action dismissed with no order against us. That is my recollection.

Q. I believe, your Honor, that is the sum and substance of what happened on this Commodity Exchange proceeding. However, I would like to ask Mr. Hall if he has refreshed his recollection sufficiently, and if not we will do so, just what the position of the company was in reply to the CEA complaint that we were speculating. A. Why, we, to the best of our ability, endeavored to prove that we actually saw a need for the quantity of corn we had in order to cover what we expected to market over a period of, my recollection, fifteen or eighteen months. 217

The Court: In other words, instead of having two million bushel in excess of your needs, you proved to them that you didn't have over two million? 218

The Witness: We didn't have any in excess of our needs. Whatever we had was what we needed for the scope of our business.

Q. Well, Mr. Hall, to refresh your recollection, there is a memorandum that Mr. Praeger prepared for you, summarizing the figures involved in these reports and just how we had computed the product commitments against which the futures were required.

Now, the first column in that report prepared for you shows "sales as reported by Quigley." A. This seems to be sales exclusively. 219

Q. Do you recall what that figure comprised? I think it was a normal order position but I would like to get your recollection of it. A. Well, I do not recall what is meant by the column "sales as reported by Quigley."

Q. Mr. Praeger— A. Huron and Keever are our estimate of the bushels of corn required to fill those contracts.

Q. Yes. Now, about those contracts, I wanted to ask you a few questions, if I may. To refresh your recollec-

220 tion, here is the original contract dated the 21st of April, 1927 between the Corn Products Refining Co. and Huron Milling Co. A. Yes.

Q. That contract, that is the corn required to produce the products to be delivered on this contract, were included in your commitments to sell products, were they not, in the reports? A. Yes. They were the estimated quantity of corn, both the Keever and Huron contracts were included in the demonstration of what our position was as to our needs.

Q. In looking at your position ahead under this contract, could you tell, say the first of January, what price
221 you were going to get from the Huron Milling Co. on the first of March? A. No.

Q. And why is that, sir? A. The contracts were all dependent upon so many factors. There was a basic price calculated on certain price of corn and the price for the actual products produced varied according to the various items.

Q. Will you just mention those. A. Well, price, for example, Price would be calculated on estimated base price of $1.80 per [illegible] pounds of thick boiling starch. That price was to be increased, that is, the base price was to
222 be increased at the rate of three cents a hundred pounds for each one-cent increase in cost of corn per bushel of corn and decreased at the same rate. It was to increase at the rate of two cents per 100 pounds for each decrease per ton in our price of feed and similarly adjusted for the price set from oil. It was also adjusted for the price of coal pay.

It was also adjusted by the hourly rate of labor at the plant. It was all these adjustments taken in before you got at the price to be charged for the finished product and that related to each month's manufacture.

Q. Now, I show you a contract dated the 12th of July, 1932, between the Corn Products and Keever Starch Co.

and ask you if you recall that contract and if the terms 223
were quite similar to the terms you described. A. The terms were, I think. The base price was slightly different, but the other factors were all the same as in the Huron contract. I mean the adjustment of what we were to charge them on top of the base price for thick boiling starch were practically identical in the two contracts. Adjustments were calculated in the same method. Your actual price, under each of those contracts, was never known until the close of the month in which the manufacturing process took place.

Mr. Kramer: With the Court's permission and 224
Mr. Mandry's consent, I would like to offer in evidence a copy of one of those contracts. He has testified that both are the same, and I don't want to clutter the record any more than necessary.

Mr. Mandry: No objection.

The Court: It is admitted.

(Whereupon the document was received in evidence as Petitioner's Exhibit 11.)

Q. Just one further question on these contracts, Mr. Hall. Would you characterize these contracts as essentially milling contracts? A. The Huron and Keever con- 225
tracts?

Q. Yes. A. Yes.

Q. They were not sales contracts? A. I wouldn't call them sales contracts at all. I think, as a matter of fact, the practice of the company—I am quite sure the charges for goods delivered under these contracts were invoiced entirely separately from those invoiced for general sales. They were treated as separate milling contracts and did not come under the jurisdiction of the general sales department.

Mr. McCain: Mr. Mandry's witness.

226 CROSS EXAMINATION

By Mr. Mandry:

Q. Mr. Hall, I am not at all clear from your explanation of what happened in the Commodity Exchange in 1940. They complained that your long position in corn was more than two million bushels, was that it?

The Court: More than two million over their demand, wasn't that it?

Mr. Kramer: Over our needs.

227 A. My recollection is the statute applied only in the event you had two million in excess of your needs and they charged us of having at a particular time more than the two million and not needed for spreading or hedging.

Q. When you speak of your needs, what needs, for what period, for how long a period? For instance, over a year you use 35 to 36 million bushels. A. I don't think the statute provided any time. The complaint against us was aimed on speculating. Whatever the speculation feature was in the market, I do not know. We demonstrated, apparently, that we needed the corn we had.

228 Q. Didn't you also have a question involved there as to your unfilled offers, the Keever orders and the Huron orders? A. That was one feature of our demonstration in this hearing as to the need for the corn.

Q. As to the need for the corn, why you had corn futures? A. We showed them what our sales commitments were, which included commitments under the Huron and Keever contracts and other things that Mr. Mueller and others have testified here to, but which we call sales commitments.

Mr. Mandry: That is all, Mr. Hall.

The Court: Is that all?

Witness excused. 229

We will recess now for lunch. We will reconvene at two o'clock.

(A recess was taken until two o'clock p. m.)

AFTERNOON SESSION

The Court: Let us proceed.

Whereupon,

230

HOLLY L. CALLENDER

was called as a witness on behalf of the Petitioner, and having been first duly sworn, testified as follows:

The Clerk: State your name and address for the record.

The Witness: Holly L. Callender, Plainfield, New Jersey.

DIRECT EXAMINATION

231

By Mr. Kramer:

Q. Mr. Callender, what is your present employment? A. I am Treasurer of the Corn Products Refining Co.

Q. How long have you been with that company? A. I have thirty-five years of service next December.

Q. Did you bring with you a photostatic copy of the 1940 tax returns? A. Yes, here it is.

Mr. Kramer: With Mr. Mandry's permission, I would like to offer this return in evidence as a joint exhibit.

232 Mr. Maudry: Perfectly all right.

Mr. Kramer: Joint Exhibit 12-H.

The Court: It is admitted.

(Whereupon the document was received in evidence as Joint Exhibit 12-H.)

Q. Are you familiar with the books and records of the company as kept in 1940? A. Yes.

Q. Will you describe to the Court the manner in which the corn futures contracts, purchases, and sales were reflected on the books of the company. A. I suppose I ought
233 to start from the beginning.

Q. Will you do that. A. Our Director of Purchases, or his assistant, would make a trade, would make a corn futures purchase through a broker. When that trade was executed, we in the accounting department would receive a confirmation of the purchase.

Q. From whom? A. From the broker, Parker & Graff, in New York City. On receipt of that confirmation of purchase, we would send it to Mr. Campbell or Mr. Praeger, who would approve that we had purchased a certain future of a certain quantity at a certain price.

234 At that time the broker would probably call on us for margin, which we would have to post.

Q. May I interrupt you there. All of these corn futures contracts were purchased on margin, is that correct? A. Yes, sir.

Q. Will you continue. A. We would post the margin with the broker and at that time we would charge the broker's account on the accounts receivable ledger. It would remain on our accounts receivable ledger until such time as the trade was closed, at which time we would recover whatever portion was left of the margin.

Q. Will you describe the bookkeeping entries which were made when a corn futures contract was closed out by

accepting delivery of grain. Will you explain how the accounts were handled. A. Yes. We would get from Parker & Graff a confirmation showing that the future contract was closed out at a certain price and at the same time we would be paying for the corn being delivered to us at the price at which the future was closed, some allowance being made for the type of corn that was delivered. There might be a discount allowed. 235

Q. May I interrupt you there. Under the contract, several grades of corn could be delivered, is that correct? A. That is right.

Q. With a price differential against the standard grade? A. Against No. 2 corn. 236

Q. You brought with you a sample "T" contract, did you not? A. Yes.

Q. Have you made copies of those? A. Yes.

Q. Now, referring to the "T" account which you brought with you, will you trace through those schedules how an account was closed out when delivery was taken of the corn. A. We might take delivery at the plant or we might take delivery at a public elevator. I will describe taking delivery at the plant first.

As I said before, when we made the purchase, we posted a margin and at that time we drew a check and that check was charged against the broker on our accounts receivable ledger. Now, when that purchase was delivered, we received from the broker a confirmation showing that it was being closed out at a certain price, and following that we received what was known as an account purchase and sales on which the broker would indicate on the left the futures that had been purchased, the quantity, the price, and the extension, and on the right he would show the futures that had been, or the corn that had been delivered against that contract, the quantity, the price, and the extension and he would arrive at a profit or loss. If there was a profit, we would credit corn miscellaneous and we would 237

238 charge the broker's account so that at that time he would be charged with the margin plus the profit, and if that completed the transaction we would have then received from the broker a check for the margin and the profit that we had made.

Q. Now, if you had a loss, how would you handle it? A. We would get a similar account purchase and sales from the broker and he would show that he was debiting our account on his books with a certain amount. We would in turn, after checking his calculations, we would in turn credit his account and debit corn miscellaneous.

239 Q. How did you handle the corn upon which you took delivery, the corn itself? A. The corn itself, of course, we had to pay for and when we paid for it, the price depending on the corn delivered, it was charged into an account in our books known as "Transit Corn" and it was kept in that account and became part of our inventory of corn at that time.

Q. Turning to the situation where instead of taking delivery of the corn you sold the futures contract. Will you describe the accounting procedure with reference to such a transaction. A. We would get from the broker a confirmation of the sale of a certain quantity at a certain

240 price. Following that we would get his account purchase and sales in which he would show on one side what we had purchased, and at what price, and the extension, and on the other side what we had sold and at what price and the extension, and they would arrive at a profit and loss. If it was a profit, we would debit his account and credit corn miscellaneous; if it was a loss, we would credit his account and credit corn miscellaneous.

Q. And at the end of your accounting period, how would the account called "Corn Miscellaneous" be handled? A. The account "Corn Miscellaneous" was closed out along with corn, the cost of corn ground against our cost of goods sold.

Q. One further question. Where no delivery of corn was taken under one of these corn futures contracts— A. You mean we had sold a future? 241

Q. Where you had sold a futures, was the inventory account in any way affected? A. No, it was not. We made no entry when we made a purchase of corn; no entry affecting any accounts on our books.

The Court: You didn't do that until you took delivery?

The Witness: At that time it did go into it.

Q. When the account was still open, it was an account with the broker? A. That is right, on which we had posted margin. And that was the only entry we had made. 242

Q. At the end of the year, in the case of contracts where you did not take delivery, it was closed out to "Corn Miscellaneous" and then finally into cost of goods sold? A. That is right.

Mr. Kramer: No further questions.

Cross Examination.

By Mr. Mandry: 243

Q. Mr. Callender, I believe you noticed on Exhibit 12-H, which is photostatic copy of the return for 1940, there is an opening and closing inventory, is there not? A. Yes, sir.

Q. Does that opening and closing inventory embrace your raw corn as well as by-products or processed products on hand at that time? A. Yes.

Q. And did you keep the inventory of cost or market, whichever is lower? A. We kept our corn and produce inventory at cost.

Q. With respect to your transactions with your broker,

244 when you closed out a future, he kept an account on his books with respect to what he owes you or what you owed him, did he not? A. Yes, sir.

Q. And when an account was closed out, if a gain, he gave you a check for the gain? A. He gave us either a credit or a check.

Q. If you wanted to liquidate the account you could have gotten the cash? A. Yes, sir.

Q. And to the contrary, if it was a loss, you would have to pay him? A. That is right.

Mr. Mandry: That is all, Mr. Callender.

245 Mr. Kramer: No further questions.

The Court: The witness is excused.

(Witness excused.)

Whereupon,

ROY PARKER

was called as a witness on behalf of the Petitioner, and having been first duly sworn, testified as follows:

246 The Clerk: State your name and address for the record.

The Witness: Roy Parker, 211 North 19th Street, East Orange, New Jersey.

DIRECT EXAMINATION

By Mr. Kramer:

Q. What is your present employment, Mr. Parker? A. Corn Products Refinery.

Q. What is your present capacity there? A. Manager in the Feed Division.

Q. During the years 1936 to 1940, what was your em- 247
ployment? A. In the Feed Division, under another manager.

Q. Of Corn Products? A. Of Corn Products.

Q. Are you familiar with the sales policy of the company with respect to feed? A. I am.

Q. What do you classify as feed? A. By-products from the manufacture of the main products of corn.

Q. You are familiar with the contents of Exhibit 9? A. That is the one you showed me, yes.

Q. With respect to the comparative dollar value? A. That is right.

Q. When you used the term "by-products," what did you 248
mean? A. Feed, meal.

Q. During the 1936 to 1940 period, what was the sales policy with respect to feed? Could you get enough feed during that period to satisfy your customers? A. At times we could and at other times we couldn't, depending on the time of the year.

Q. As far as you know, was the policy of the company to purchase corn for grinding merely to supply feed to customers? A. Never in the 38 years I have been there. I wish they would at times.

Q. In other words, what you are saying is if you had 249
feed as a result of the other processes of the company as a by-product, you would sell it? A. Absolutely.

Q. Under what terms did you sell feed to customers as a general policy? A. As general policy, we sell for a calendar month.

Q. During the 1936 to 1940 period did that change at all? A. Not that I recall, no.

Q. Did you on occasion make certain forward commitments? A. To some customers we did.

Q. And when you made those commitments, what was the situation as far as the price factor was concerned?

250 A. The price is the same for a calendar month. There isn't any price factor in the forward selling.

Q. Was there any guarantee made in the price declarations? A. The same as for the calendar month, whatever that price decline happened to be.

Q. I show you a contract, or a writing, dated May 17, 1939, and ask you if you can identify it. A. I do, definitely.

Q. What is that, sir? A. That was an assurance to that particular customer that if we had that much product available we would sell him that much on a calendar month basis.

251 Q. You say if you had that much by-product available you would sell it to him at the price? A. Yes.

Q. And what was the agreement as to price? A. Whatever is the first named price for the calendar month; just the same as we would sell anyone else.

Q. What would happen if the price declined? A. If there was a guarantee, he would get the benefit of it.

Mr. Kramer: I have no further questions.

Cross Examination

252 By Mr. Mandry:

Q. Mr. Parker, did you testify that you only sold feed products when you had it on hand? A. We sell ahead on the calendar month, anticipate what we are going to have and sell on that basis.

Q. But you sold in excess of what you had at the time you made the order, frequently, did you not? A. I don't quite understand.

Q. Didn't you have unfilled orders for feed in excess of the amount of stock on hand? A. Stock on hand in plant production for the calendar month is our policy, not to overdo it, because if we sold more the customer wouldn't

get it. That isn't good selling policy when you are working with a by-product. You can't hit it exactly. You try to, yes. 253

Q. Are you familiar with Exhibit 6-F, an analysis of the feed situation from July 4, 1938 to December 30, 1940? Are you familiar with that exhibit? A. I don't know as I am or not.

Q. This exhibit runs by weeks for a period of about three years and I don't want to carry you throughout all of that, but let us look for an instance in June 8, 1940. Does that show unfilled orders in excess of your stock on hand? A. The calendar month sale is the stock on hand plus the anticipated production for that month. 254

Q. But at the end of that week you had 17,000 tons on hand and you had unfilled orders for 27,000 tons, did you not? A. The end of that week?

Q. The end of that week. A. That apparently covered the calendar month sales.

Q. No, it covers only one week. A. We weren't selling on a weekly basis.

Q. I am speaking—this exhibit shows at the end of each week. So you did have unfilled orders in excess of stock on hand at various times, did you not? A. We always have excess orders. 255

Q. Excess unfilled orders? A. Excess of stock on hand because our sale is made for the calendar months which anticipates production.

Q. And in order to have the feed products you sold, you had to buy raw corn, did you not? A. I had nothing to do with the buying of corn.

Q. But the feed products is made out of corn, is it not? A. Definitely.

Mr. Mandry: That is all.

256 RE-DIRECT EXAMINATION

By Mr. Kramer:

Q. During May of 1939, you made an agreement, did you not, with the Eastern Milling Co.? A. Eastern States Milling Co.

Q. For forward sale of feed? A. Yes.

Q. Is this a copy of that original contract? A. I would say so, signed by Mr. Kayhart.

Mr. Kramer: I would like to offer in evidence a copy of that contract, with the permission of the
257 Government's counsel.

Mr. Mandry: No objection.

The Court: It is admitted.

(Whereupon the document was received in evidence as Petitioner's Exhibit 13.)

Q. Now, this was the contract where you committed yourself, as I understand it, to deliver feed beyond a 30-day period? A. That is right.

Q. What was the situation as far as price was concerned? A. It was sold at the same price as calendar month.

258 Q. And the price guarantee? A. Whatever that guarantee was that prevailed at the time would apply on that, too.

Mr. Kramer: The contract speaks for itself. I won't question the witness any further on that.

Mr. Mandry: No further questions.

Mr. Kramer: One further question.

By Mr. Kramer:

Q. Was it only in May of 1939 that you did this, or was that general with respect to that forward commitment? A. That was not a general practice and it wasn't done for everyone, just a few.

Mr. Kramer: That is all, Mr. Parker. 259

Mr. Mandry: Mr. Parker, just a word.

RE-CROSS EXAMINATION

By Mr. Mandry:

Q. You said it was not the general practice. Now, this contract, Exhibit 13, is with the Eastern States Milling Co.? A. That is right.

Q. Did you have somewhat similar contracts with the Keever Starch Co. and the Huron Milling Co.? A. Never sold feed to the Keever Starch Company or the Huron Milling Co. that I know of. 260

Q. You didn't handle that business?. A. We never sold any feed, as far as I can remember, to either company.

Mr. Mandry: That is all.

Mr. Kramer: They weren't in the feed business, were they?

The Witness: Not in the feed business, as far as I can recall. Never sold them.

Mr. Kramer: That is all.

The Court: The witness is excused.

(Witness excused.)

261

Whereupon,

W. E. HENRY

was called as a witness on behalf of the Petitioner, and having been first duly sworn, testified as follows:

The Clerk: State your name and address for the record.

The Witness: W. E. Henry, River Forest, Illinois.

262 DIRECT EXAMINATION

By Mr. Kramer:

Q. Mr. Henry, will you endeavor to speak slowly and keep your voice up so that Mr. Mandry and I can hear you?

What is your present employment? A. Manager of the Grain Department of Corn Products Refining Co.

Q. When you say Manager of the Grain Department, what are your functions? A. Buy grain at the lowest price possible and keep the plant supplied.

Q. Are you a member of the Chicago Board of Trade?

263 A. I am.

Q. How long have you been a member of that organization? A. Since 1943.

Q. Prior to that what was your experience? A. Experience or membership?

Q. What was your business prior to 1943? A. In the milling business, flour milling business.

Q. How long have you been in the flour milling business prior to 1943? A. Twenty-four years.

Q. Did you ever work for any governmental agencies? A. From 1941 to 1943 with the Commodity Credit Corporation.

264 Q. What were your functions there? A. Grain specialist.

Q. Are you familiar with the rules and regulations of the Chicago Board of Trade? A. I am.

Q. Did you bring with you a copy of the regulations and by-laws at my request? A. I have.

Q. Are you familiar with the steps taken in trading in corn futures on the Chicago Board of Trade? A. I am.

Q. Does the Corn Products Refining Co. today buy all of its corn futures contracts, if any, on the Chicago Board of Trade? A. Generally speaking, yes.

Q. And during the period 1940, to the best of your recol-

lection, did it buy all of its contracts? A. I just came 265
with the company in 1944. Prior to that I wouldn't know.

Q. I understand. Now, will you describe how a corn futures contract is acquired on the Chicago Board of Trade. A. We would give a broker an order to buy so many bushels at such and such a price.

Q. When you speak in terms of a contract, I believe a previous witness has testified that a contract consists of 5,000 bushels as a unit. A. That is the unit.

Q. Did you bring with you a form of such an order to a broker? A. No, not an order; a confirmation of trade. The order would be verbal.

Q. The order would be verbal but the confirmation 266
would be in writing? A. That is right.

Q. May I have two of those. (Witness hands paper to Mr. Kramer.) To your knowledge, has this form been in effect for some years? A. It has.

Q. Was it in effect in 1940, as far as you know? A. As far as I know, yes.

Mr. Kramer: With respondent's permission, I would like to offer in evidence a copy of the purchase.

Mr. Mandry: No objection.

The Court: It is admitted. 267

(Whereupon the document was received in evidence as Petitioner's Exhibit 14.)

Mr. Kramer: I would like to read just briefly one clause in that exhibit, if I may.

The Court: What for?

Mr. Kramer: If your Honor will bear with me, it is for the purpose of proving——

The Court: Do you want to read it for my benefit or his, because I can read it myself.

Mr. Kramer: My purpose was to show that one

268 contract is the same as any other on the Exchange with reference to Section 118, especially.

Q. Now, have you also brought with you a form when a corn futures contract is sold? A. Right here.

Q. That is the confirmation of the sale? A. Yes, so marked.

Q. Do you have two copies of that? A. Yes (handing documents).

Mr. Kramer: I would like to offer in evidence, with respondent's permission, a copy of the confirmation of sale.

269 The Court: It is admitted.

(Whereupon the document was received in evidence as Petitioner's Exhibit 15.)

Q. Is there any difference, as far as you know, between one corn futures contracts and any other corn futures contract except as to date of maturity? A. No.

Q. They are all identical? A. Yes.

Q. Do you know who the original seller of the corn futures contract is at any given point? A. No.

Q. You don't know who the ultimate purchaser is at any given time, do you? A. We would be the purchaser.

270 Q. I mean, if you sold it, you would sell it through a broker? A. That is right. We would have no concern with it.

Q. Will you describe how you go about taking delivery under a corn futures contract. A. If we were long in futures and elected to take delivery, we would be notified through the Clearing House; the Clearing House would notify our commission merchant that such-and-such an amount of bushels was being delivered to them for our account and we would pay for it.

Q. Where would delivery ordinarily take place under the rules of the Exchange? A. In a regular warehouse.

Q. And that would be in what area? A. In the Chicago switching limits. 271

The Court: Each one of these quantities is for delivery for a specific quantity at a certain date?

The Witness: At the expiration of the futures.

The Court: And that is a certain date, so when that date comes around you either have to dispose of the contract before that date or else take delivery on that date?

The Witness: That is right.

Q. As far as you know, is such a contract fully negotiable or transferable? A. It is. 272

Q. Did the Chicago Board of Trade maintain a regular market for the disposal or the purchase of such contracts? A. That is right.

Q. Are you familiar with the term "hedging" as previously described in the opening statement? A. A hedge is a balanced position.

Q. When you say "A hedge is a balanced position," can it take one of several forms? A. It can, but you must have specific price on both ends, an irrevocable contract.

Q. It must be an irrevocable contract with a specific price, you say? A. That is right.

Q. Would you say a short sale against inventory was a hedge? A. Well, it could be. 273

Q. And a long futures position against definite future forward commitments? A. At a price?

Q. At a price. A. Yes.

Q. But lacking a price, would it be a hedge, in your opinion? A. It would not.

Q. You said, in response to an earlier question, that a hedge was a balanced position. A. Yes.

Q. I would like you to look at Exhibit 7-G in evidence and see whether you can determine at any given point

274 where the petitioner was maintaining a hedged position. A. It doesn't look like it from this graph.

Q. Will you look at all years. A. Here sales went up and purchases went down. I would say no.

Mr. Kramer: No further questions.

CROSS EXAMINATION

By Mr. Mandry:

Q. Mr. Henry, I am not at all clear on your explanation of closing out of futures purchase contracts where you do not accept delivery. Now, you have stated in the first
275 instance that you give to your broker a verbal order to purchase such-and-such a quantity at such a price for delivery in a certain contract month and he sends you a confirmation of that, and that confirmation says it contemplates the actual receipt and delivery of the property. A. That is right.

Q. When it comes up to some period shortly before the maturity date of the futures, what do you actually do when you are not going to accept delivery? Do you telephone the broker? A. Or see him in person and tell him to sell so much at such-and-such a price or sell so much to the market.

276 Q. If you had a futures contract for 10,000 bushels for May, you would tell him to sell for you 10,000 bushels for May delivery, would you not? A. That is right.

Q. And he would send you a confirmation when you put in an order for sale? A. That is right, the execution of the order.

Q. You have stated certain definitions of hedges. Where did you get those definitions from? A. I have been in this business since 1920 and I had to live with it during that period and that has been my experience.

Q. Was that experience coming out from being a member of the Chicago Board of Trade for their purposes out

there? A. That, and I was a member of the St. Louis Merchants Exchange since 1918. 277

Q. And that would be the experience from which you have drawn your definition of a hedge? A. That is correct.

Q. I believe you stated—what was that statement of a hedge, that you have something with a definite price? A. Yes.

Q. What was that statement again? A. If you have a definite purchase price and a definite sale price, you have something that is balanced. Therefore, it could be a hedge.

Q. What would you think of this definition, and I will read it to you: "A hedge transaction on Commodity Exchange, Inc. is defined as a purchase or sale of future contracts subject to the by-laws and rules of the Exchange, executed for the purpose of minimizing a price risk or facilitating a customary or normal conduct of business." 278

What would you think of that definition? A. I would say that is probably pertaining to an elevator man who was accumulating grain and selling a future against it to minimize his risk.

Q. That is one of the definitions of a hedge by the Commodity Exchange of New York. A. Yes. 279

Q. Do you agree with what I read? A. He would buy corn at a specific price and he would sell futures at a specific price and they would both move simultaneously, presumably.

Q. Do you agree with the portion I just read? A. Yes, I say essentially that is correct.

Mr. Mandry: That is all.

280 RE-DIRECT EXAMINATION

By Mr. Kramer:

Q. The Chicago Board of Trade, I understand, also lists certain stocks and bonds, is that correct? A. That is right.

Q. You have a post on that? A. Yes.

Q. Is there any essential difference, as far as you know, between trading in securities on margin and trading in corn futures on margin? A. No, they are all negotiable.

281 Mr. Kramer: That is all.

Mr. Mandry: No questions.

The Court: The witness is excused.

(Witness excused.)

Mr. Kramer: I believe that is the Petitioner's case.

Mr. Mandry: Respondent rests.

The Court: The case stands submitted. On the matter of filing briefs, I suppose you can file simultaneous briefs.

Mr. Kramer: I would be happy to do so.

The Court: Time for filing briefs will be sixty

282 and thirty.

The Clerk: August 14, 1950 for main briefs and September 13 for reply briefs.

The Court: I would like to compliment counsel on their expeditious handling of the case. I am always glad to see a good job well done.

(Whereupon, at 2:50 o'clock p. m., the hearing was concluded.)

Joint Exhibit 6-F.

CORN PRODUCTS REFINING COMPANY
WEEKLY REPORTS, STOCKS AND ORDERS
(In Bushels)

	7/1/38		7/10/38		7/17/38		7/24/38		8/1/38		8/7/38	
	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders
Cerelose	610,000	210,000	515,000	210,000	530,000	175,000	555,000	160,000	565,000	160,000	600,000	155,000
Bulk	1,435,000	710,000	1,350,000	710,000	1,260,000	1,150,000	1,375,000	1,145,000	1,450,000	1,150,000	1,480,000	975,000
Package	520,000	65,000	500,000	65,000	520,000	60,000	540,000	55,000	555,000	75,000	550,000	65,000
Total	2,565,000	985,000	2,365,000	985,000	2,410,000	1,385,000	2,470,000	1,360,000	2,570,000	1,385,000	2,630,000	1,195,000
	8/14/38		8/21/38		8/28/38		9/1/38		9/11/38		9/18/38	
Cerelose	595,000	145,000	610,000	135,000	550,000	130,000	590,000	135,000	565,000	1,355,000	570,000	1,535,000
Bulk	1,500,000	820,000	1,570,000	710,000	1,590,000	635,000	1,650,000	660,000	1,655,000	580,000	1,770,000	580,000
Package	575,000	75,000	625,000	65,000	630,000	75,000	650,000	95,000	620,000	115,000	595,000	105,000
Total	2,670,000	1,040,000	2,805,000	910,000	2,770,000	840,000	2,890,000	890,000	2,840,000	2,050,000	2,935,000	2,220,000
	9/25/38		10/1/38		10/9/38		10/16/38		10/23/38		11/1/38	
Cerelose	585,000	1,355,000	580,000	1,335,000	550,000	1,110,000	535,000	1,100,000	510,000	1,380,000	500,000	760,000
Bulk	1,720,000	1,140,000	1,700,000	2,190,000	1,685,000	1,700,000	1,720,000	1,360,000	1,700,000	980,000	1,650,000	820,000
Package	540,000	100,000	540,000	110,000	525,000	100,000	550,000	80,000	570,000	85,000	600,000	70,000
Total	2,845,000	2,595,000	2,820,000	3,635,000	2,760,000	2,910,000	2,805,000	2,540,000	2,780,000	2,445,000	2,750,000	1,650,000
	11/6/38		11/13/38		11/20/38		11/27/38		12/1/38		12/11/38	
Cerelose	480,000	465,000	525,000	235,000	665,000	115,000	780,000	150,000	815,000	180,000	1,050,000	235,000
Bulk	1,670,000	800,000	1,650,000	640,000	1,525,000	960,000	1,480,000	1,835,000	1,430,000	1,830,000	1,480,000	1,350,000
Package	625,000	60,000	650,000	55,000	670,000	60,000	715,000	75,000	710,000	80,000	720,000	450,000
Total	2,775,000	1,325,000	2,825,000	930,000	2,860,000	1,135,000	2,975,000	2,060,000	2,955,000	2,090,000	3,250,000	1,630,000
	12/18/38		12/23/38		1/1/39		1/8/39		1/15/39		1/22/39	
Cerelose	1,195,000	1,135,000	1,330,000	1,080,000	1,375,000	960,000	1,360,000	805,000	1,425,000	595,000	1,430,000	455,000
Bulk	1,470,000	1,485,000	1,559,000	2,000,000	1,500,000	1,779,000	1,500,000	1,500,000	1,475,000	1,210,000	1,480,000	900,000
Package	780,000	100,000	820,000	115,000	780,000	220,000	705,000	215,000	670,000	250,000	620,000	300,000
Total	3,445,000	2,720,000	3,700,000	3,195,000	3,655,000	2,950,000	3,565,000	2,520,000	3,570,000	2,055,000	3,530,000	1,655,000
	2/1/39		2/12/39		2/19/39		3/1/39		3/5/39		3/12/39	
Cerelose	1,465,000	375,000	1,540,000	150,000	1,630,000	160,000	1,610,000	145,000	1,625,000	245,000	1,585,000	1,280,000
Bulk	1,455,000	775,000	1,640,000	695,000	1,700,000	620,000	1,675,000	800,000	1,675,000	1,035,000	1,690,000	1,130,000
Package	610,000	405,000	630,000	350,000	620,000	225,000	585,000	185,000	585,000	155,000	540,000	130,000
Total	3,530,000	1,555,000	3,810,000	1,195,000	3,950,000	1,005,000	3,870,000	1,130,000	3,885,000	1,435,000	3,815,000	2,540,000
	3/19/39		3/26/39		4/1/39		4/9/39		4/16/39		4/23/39	
Cerelose	1,535,000	1,165,000	1,475,000	1,300,000	1,545,000	1,490,000	1,160,000	1,190,000	1,130,000	1,010,000	1,210,000	960,000
Bulk	1,660,000	1,050,000	1,625,000	1,020,000	1,600,000	990,000	1,565,000	980,000	1,535,000	900,000	1,525,000	1,100,000
Package	530,000	100,000	520,000	85,000	560,000	70,000	580,000	65,000	605,000	70,000	610,000	70,000
Total	3,725,000	2,315,000	3,620,000	2,405,000	3,505,000	2,550,000	3,305,000	2,235,000	3,270,000	1,980,000	3,345,000	2,130,000
	5/1/39		5/7/39		5/14/39		5/21/39		6/1/39		6/11/39	
Cerelose	1,235,000	760,000	1,275,000	600,000	1,320,000	475,000	1,335,000	320,000	1,240,000	225,000	1,325,000	185,000
Bulk	1,550,000	2,200,000	1,475,000	2,080,000	1,570,000	1,690,000	1,575,000	1,430,000	1,500,000	1,100,000	1,540,000	850,000
Package	600,000	75,000	600,000	75,000	580,000	100,000	610,000	120,000	600,000	105,000	640,000	105,000
Total	3,385,000	3,035,000	3,350,000	2,755,000	3,470,000	2,265,000	3,520,000	1,870,000	3,340,000	1,430,000	3,505,000	1,140,000

Joint Exhibit 6-F,

CORN PRODUCTS REFINING COMPANY

WEEKLY REPORTS, STOCKS AND ORDERS

(In Bushels)

	6/18/39		6/25/39		7/1/39		7/9/39		7/16/39		7/23/39	
	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders
Cerelose	1,320,000	190,000	1,230,000	160,000	1,180,000	175,000	1,180,000	170,000	1,150,000	185,000	1,050,000	270,000
Bulk	1,520,000	765,000	1,530,000	760,000	1,640,000	850,000	1,530,000	740,000	1,470,000	900,000	1,425,000	760,000
Package	610,000	150,000	595,000	275,000	600,000	380,000	600,000	380,000	600,000	360,000	535,000	290,000
Total	3,430,000	1,105,000	3,355,000	1,195,000	3,420,000	1,405,000	3,310,000	1,290,000	3,220,000	1,445,000	3,010,000	1,320,000
	8/1/39		8/8/39		8/13/39		8/20/39		8/27/39		9/1/39	
Cerelose	990,000	245,000	990,000	235,000	975,000	210,000	930,000	175,000	930,000	150,000	910,000	205,000
Bulk	1,375,000	750,000	1,325,000	670,000	1,345,000	575,000	1,395,000	695,000	1,395,000	1,835,000	1,400,000	2,535,000
Package	515,000	175,000	505,000	120,000	535,000	113,000	565,000	65,000	620,000	80,000	650,000	110,000
Total	2,880,000	1,170,000	2,820,000	1,025,000	2,855,000	895,000	2,890,000	935,000	2,945,000	2,065,000	2,960,000	2,850,000
	9/10/39		9/17/39		9/24/39		10/1/39		10/8/39		10/15/39	
Cerelose	760,000	1,025,000	515,000	1,550,000	440,000	1,645,000	360,000	1,565,000	345,000	1,425,000	400,000	1,190,000
Bulk	1,300,000	2,160,000	1,235,000	1,735,000	1,250,000	1,650,000	1,150,000	1,615,000	1,140,000	1,380,000	1,215,000	1,250,000
Package	585,000	235,000	495,000	650,000	385,000	800,000	380,000	830,000	410,000	770,000	435,000	690,000
Total	2,645,000	3,420,000	2,245,000	3,935,000	2,075,000	4,095,000	1,890,000	4,010,000	1,895,000	3,575,000	2,050,000	3,130,000
	10/22/39		11/1/39		11/5/39		11/12/39		11/19/39		11/26/39	
Cerelose	375,000	935,000	435,000	760,000	465,000	550,000	500,000	470,000	620,000	360,000	740,000	300,000
Bulk	1,285,000	1,040,000	1,450,000	980,000	1,465,000	880,000	1,450,000	800,000	1,430,000	500,000	1,450,000	595,000
Package	435,000	575,000	450,000	350,000	470,000	270,000	480,000	175,000	560,000	90,000	550,000	50,000
Total	2,095,000	2,550,000	2,335,000	2,090,000	2,430,000	1,700,000	2,430,000	1,445,000	2,550,000	950,000	2,740,000	945,000
	12/1/39		12/10/39		12/17/39		12/24/39		1/1/40		1/7/40	
Cerelose	810,000	185,000	980,000	220,000	1,105,000	365,000	1,200,000	335,000	1,170,000	375,000	1,245,000	370,000
Bulk	1,495,000	783,000	1,440,000	2,138,000	1,440,000	2,425,000	1,460,000	2,150,000	1,375,000	1,960,000	1,395,000	1,880,000
Package	605,000	50,000	665,000	35,000	730,000	40,000	775,000	60,000	725,000	85,000	725,000	70,000
Total	2,910,000	1,018,000	3,085,000	2,393,000	3,275,000	2,830,000	3,435,000	2,545,000	3,270,000	2,420,000	3,365,000	2,320,000
	1/14/40		1/21/40		1/28/40		2/1/40		2/11/40		2/18/40	
Cerelose	1,235,000	405,000	1,330,000	1,125,000	1,420,000	6,410,000	1,495,000	6,800,000	1,570,000	6,515,000	1,630,000	6,425,000
Bulk	1,350,000	1,590,000	1,390,000	1,610,000	1,410,000	1,050,000	1,415,000	970,000	1,360,000	790,000	1,360,000	625,000
Package	725,000	50,000	715,000	40,000	715,000	60,000	735,000	65,000	760,000	65,000	790,000	65,000
Total	3,310,000	2,045,000	3,435,000	2,775,000	3,545,000	7,520,000	3,645,000	7,835,000	3,690,000	7,370,000	3,780,000	7,115,000
	2/25/40		3/1/40		3/10/40		3/17/40		3/24/40		4/1/40	
Cerelose	1,650,000	6,300,000	1,650,000	6,265,000	1,640,000	6,850,000	1,645,000	5,855,000	1,670,000	5,680,000	1,680,000	5,625,000
Bulk	1,380,000	1,500,000	1,400,000	1,730,000	1,370,000	1,450,000	1,350,000	1,025,000	1,420,000	880,000	1,385,000	1,080,000
Package	800,000	65,000	770,000	60,000	765,000	60,000	760,000	70,000	750,000	70,000	735,000	65,000
Total	3,830,000	7,865,000	3,820,000	8,055,000	3,775,000	8,360,000	3,755,000	6,950,000	3,840,000	6,630,000	3,800,000	6,770,000

Joint Exhibit 6-F.

CORN PRODUCTS REFINING COMPANY
WEEKLY REPORTS, STOCKS AND ORDERS
(In Bushels)

	4/8/40		4/14/40		4/21/40		5/1/40		5/12/40		5/19/40	
	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders
Cerelose	1,750,000	5,360,000	1,820,000	5,170,000	1,815,000	4,650,000	1,810,000	4,300,000	1,860,000	3,945,000	1,835,000	3,820,000
Bulk	1,300,000	1,360,000	1,300,000	1,415,000	1,280,000	1,240,000	1,250,000	1,885,000	1,200,000	1,560,000	1,205,000	1,440,000
Package	720,000	70,000	700,000	65,000	675,000	60,000	640,000	85,000	615,000	175,000	580,000	240,000
Total	3,770,000	6,790,000	3,820,000	6,650,000	3,770,000	5,950,000	3,700,000	6,270,000	3,675,000	5,680,000	3,620,000	4,500,000

	5/26/40		6/1/40		6/9/40		6/16/40		6/23/40		7/1/40	
Cerelose	1,815,000	3,720,000	1,850,000	2,945,000	1,815,000	2,765,000	1,825,000	2,560,000	1,800,000	2,360,000	1,825,000	2,115,000
Bulk	1,180,000	1,620,000	1,280,000	1,710,000	1,350,000	2,040,000	1,395,000	1,880,000	1,475,000	1,590,000	1,475,000	1,400,000
Package	600,000	320,000	610,000	500,000	605,000	500,000	600,000	500,000	630,000	500,000	665,000	500,000
Total	3,595,000	5,660,000	3,740,000	5,155,000	3,770,000	5,305,000	3,820,000	4,940,000	3,905,000	4,450,000	3,965,000	4,015,000

	7/7/40		7/14/40		7/21/40		7/28/40		8/1/40		8/11/40	
Cerelose	1,680,000	1,860,000	1,580,000	2,530,000	1,540,000	2,370,000	1,500,000	2,100,000	1,460,000	1,840,000	1,210,000	1,400,000
Bulk	1,350,000	1,230,000	1,230,000	1,220,000	1,250,000	1,080,000	1,280,000	700,000	1,340,000	1,100,000	1,380,000	1,190,000
Package	660,000	500,000	645,000	500,000	610,000	500,000	590,000	500,000	530,000	500,000	530,000	500,000
Total	3,690,000	3,590,000	3,455,000	4,250,000	3,400,000	3,950,000	3,370,000	3,300,000	3,350,000	3,440,000	3,120,000	3,090,000

	8/18/40		8/25/40		9/1/40		9/8/40		9/15/40		9/22/40	
Cerelose	1,040,000	1,080,000	1,030,000	895,000	1,045,000	855,000	1,050,000	870,000	1,030,000	835,000	1,075,000	760,000
Bulk	1,380,000	1,030,000	1,415,000	930,000	1,400,000	925,000	1,370,000	830,000	1,340,000	910,000	1,335,000	1,130,000
Package	530,000	500,000	545,000	500,000	545,000	500,000	550,000	500,000	560,000	500,000	560,000	500,000
Total	2,950,000	2,610,000	2,980,000	2,325,000	2,990,000	2,280,000	2,970,000	2,200,000	2,930,000	2,245,000	2,970,000	2,390,000

	10/1/40		10/6/40		10/13/40		10/20/40		10/27/40		11/1/40	
Cerelose	1,080,000	690,000	1,035,000	650,000	1,065,000	150,000	1,100,000	170,000	1,110,000	155,000	1,150,000	200,000
Bulk	1,340,000	1,035,000	1,340,000	900,000	1,340,000	700,000	1,380,000	620,000	1,410,000	495,000	1,465,000	450,000
Package	600,000	500,000	595,000	500,000	585,000	500,000	600,000	500,000	600,000	500,000	625,000	500,000
Total	3,000,000	2,225,000	2,970,000	2,050,000	2,990,000	1,350,000	3,080,000	1,290,000	3,120,000	1,150,000	3,240,000	1,150,000

	11/10/40		11/17/40		11/24/40		12/1/40		12/8/40		12/15/40	
Cerelose	1,170,000	160,000	1,300,000	135,000	1,280,000	145,000	1,320,000	195,000	1,340,000	180,000	1,385,000	180,000
Bulk	1,380,000	390,000	1,450,000	370,000	1,385,000	300,000	1,285,000	495,000	1,275,000	960,000	1,260,000	1,290,000
Package	620,000	500,000	630,000	500,000	635,000	500,000	650,000	500,000	655,000	500,000	665,000	500,000
Total	3,170,000	1,050,000	3,380,000	1,005,000	3,300,000	945,000	3,255,000	1,190,000	3,270,000	1,640,000	3,310,000	1,970,000

	12/22/40		1/1/41	
Cerelose	1,475,000	1,380,000	1,425,000	1,125,000
Bulk	1,255,000	1,160,000	1,210,000	925,000
Package	680,000	500,000	695,000	500,000
Total	3,410,000	3,040,000	3,330,000	2,550,000

Joint Exhibit 6-F.

CORN PRODUCTS REFINING COMPANY

ANALYSIS OF "FEED SITUATION" FROM JULY 4, 1938 TO DECEMBER 30, 1940, INCLUSIVE

(In Tons)

	7/4/38		7/11/38		7/18/38		7/25/38		8/1/38		8/8/38	
	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal
Stock	17,186	547	19,312	557	19,953	548	21,296	766	18,241	736	18,958	322
Unfilled Orders	17,683	3,441	17,891	3,273	24,731	5,890	24,947	5,549	18,374	4,748	15,451	4,046
	8/15/38		8/22/38		8/29/38		9/5/38		9/12/38		9/19/38	
Stock	21,793	992	24,921	1,204	27,078	1,708	27,590	1,678	29,644	1,951	31,762	1,971
Unfilled Orders	17,661	5,348	16,467	5,404	14,963	5,146	13,991	3,837	12,815	3,516	25,842	6,872
	9/26/38		10/3/38		10/10/38		10/17/38		10/24/38		10/31/38	
Stock	33,359	1,815	32,175	1,178	34,876	1,180	38,647	1,039	40,564	1,004	38,644	757
Unfilled Orders	25,952	7,362	21,857	6,013	19,370	5,244	20,252	4,644	25,048	6,858	20,229	5,938
	11/7/38		11/14/38		11/21/38		11/28/38		12/5/38		12/12/38	
Stock	36,747	697	39,269	373	39,837	242	41,128	228	39,746	309	41,426	97
Unfilled Orders	15,942	5,027	23,926	5,843	24,373	7,413	22,673	6,726	19,101	5,709	29,576	4,813
	12/19/38		12/26/38		1/2/39		1/9/39		1/16/39		1/23/39	
Stock	43,667	367	44,468	326	41,376	258	40,644	343	40,000	409	38,690	403
Unfilled Orders	31,899	5,922	29,780	5,711	24,643	5,464	36,263	8,174	33,936	7,368	30,050	6,089
	1/30/39		2/6/39		2/13/39		2/20/39		2/27/39		3/6/39	
Stock	36,743	497	34,917	443	34,938	526	34,976	584	33,552	759	30,022	782
Unfilled Orders	25,076	5,258	20,084	4,452	18,566	3,981	29,544	6,176	28,654	5,903	22,949	5,269
	3/13/39		3/20/39		3/27/39		4/3/39		4/10/39		4/17/39	
Stock	28,176	806	25,107	525	22,889	336	18,954	373	15,585	387	14,006	322
Unfilled Orders	20,611	4,320	15,895	3,306	29,396	6,418	23,997	5,438	19,952	4,443	30,152	6,952
	4/24/39		5/1/39		5/8/39		5/15/39		5/22/39		5/29/39	
Stock	11,421	497	5,601	454	4,711	451	5,648	748	7,851	1,183	7,496	1,359
Unfilled Orders	27,913	6,357	19,508	5,509	16,222	4,782	13,776	3,847	20,988	5,741	17,901	5,123
	6/5/39		6/12/39		6/19/39		6/26/39		7/3/39		7/10/39	
Stock	6,897	1,131	8,708	1,617	10,753	1,632	11,322	1,441	12,129	1,185	12,084	1,203
Unfilled Orders	14,282	4,086	13,025	3,537	10,289	3,039	14,915	4,252	12,941	2,583	11,957	2,174
	7/17/39		7/24/39		7/31/39		8/7/39		8/14/39		8/21/39	
Stock	13,878	1,139	14,021	951	14,756	988	14,203	1,044	15,546	1,374	16,747	1,666
Unfilled Orders	10,052	1,671	14,090	4,075	15,616	3,644	12,516	3,380	10,077	3,424	18,675	5,411

Joint Exhibit 6-F.

CORN PRODUCTS REFINING COMPANY

ANALYSIS OF "FEED SITUATION" FROM JULY 4, 1938 TO DECEMBER 30, 1940, INCLUSIVE

(In Tons)

	8/28/39		9/4/39		9/11/39		9/18/39		9/25/39		10/3/39	
	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal
Stock	16,786	1,494	14,934	1,301	13,240	1,310	12,240	1,147	12,505	934	12,227	732
Unfilled Orders	24,037	5,498	21,245	5,040	21,452	4,544	17,558	2,962	19,453	3,138	14,349	2,106
	10/9/39		10/16/39		10/23/39		10/30/39		11/6/39		11/13/39	
Stock	15,825	1,206	19,355	2,298	20,996	3,012	22,591	3,428	22,193	3,658	22,683	3,692
Unfilled Orders	13,219	3,115	11,160	2,595	23,378	4,468	22,461	4,240	18,287	3,904	16,549	3,677
	11/20/39		11/27/39		12/4/39		12/11/39		12/18/39		12/25/39	
Stock	23,641	3,181	22,293	2,240	19,279	1,336	19,192	1,223	20,843	1,410	21,891	1,489
Unfilled Orders	30,573	6,675	28,884	6,414	22,671	5,332	20,665	4,519	35,462	7,335	34,344	7,457
	1/1/40		1/8/40		1/15/40		1/22/40		1/29/40		2/5/40	
Stock	17,344	546	17,697	510	17,536	1,017	18,260	1,461	19,420	1,832	18,640	1,965
Unfilled Orders	27,631	6,384	24,009	5,490	20,488	4,686	25,884	7,084	22,984	6,562	17,572	5,162
	2/12/40		2/19/40		2/26/40		3/4/40		3/11/40		3/18/40	
Stock	20,247	2,463	21,617	3,202	22,879	3,557	20,362	3,525	20,613	3,930	20,781	4,034
Unfilled Orders	14,861	4,386	21,880	6,131	21,931	6,282	17,845	4,649	16,358	4,303	24,801	5,341
	3/25/40		4/1/40		4/8/40		4/15/40		4/22/40		4/29/40	
Stock	20,945	4,776	19,898	4,027	17,473	4,255	17,125	4,325	16,985	4,401	12,644	4,404
Unfilled Orders	25,176	6,298	21,545	5,878	17,468	5,308	29,339	7,273	29,622	6,645	25,296	5,723
	5/6/40		5/13/40		5/20/40		5/27/40		6/3/40		6/10/40	
Stock	8,366	4,405	8,885	4,750	10,359	5,471	13,361	6,794	15,046	7,511	17,153	8,618
Unfilled Orders	17,718	4,711	14,177	3,490	11,919	2,918	10,208	2,262	11,506	2,775	11,619	2,832
	6/18/40		6/24/40		7/1/40		7/8/40		7/15/40		7/22/40	
Stock	19,935	9,601	21,797	10,239	19,933	10,105	17,088	9,614	15,579	9,495	15,151	9,696
Unfilled Orders	11,512	2,727	10,361	2,142	15,911	2,375	13,214	2,274	12,084	2,182	11,291	1,521
	7/29/40		8/5/40		8/12/40		8/19/40		8/27/40		9/2/40	
Stock	14,178	10,208	9,701	9,585	9,996	9,844	11,350	10,924	11,733	11,464	8,548	11,371
Unfilled Orders	21,710	3,726	16,347	4,349	14,541	3,744	12,267	3,112	20,801	6,251	14,654	5,322
	9/9/40		9/16/40		9/23/40		9/30/40		10/7/40		10/14/40	
Stock	8,071	11,677	8,473	11,793	8,417	11,854	6,372	11,288	4,191	10,961	4,507	10,671
Unfilled Orders	13,211	5,958	15,046	4,395	27,284	7,505	25,151	6,286	21,011	4,941	18,358	4,135
	10/21/40		10/28/40		11/4/40		11/11/40		11/18/40		11/25/40	
Stock	4,930	10,635	5,160	9,795	3,016	7,882	4,300	7,751	4,766	6,324	3,459	5,029
Unfilled Orders	33,054	6,194	29,465	7,152	22,280	5,972	18,312	6,210	12,762	5,016	8,760	3,374
	12/2/40		12/9/40		12/16/40		12/23/40		12/30/40			
Stock	2,236	3,024	2,014	2,592	4,168	2,527	6,088	2,794	6,790	2,503		
Unfilled Orders	22,584	5,673	18,138	4,653	12,493	3,663	9,282	2,749	4,957	1,933		

298

Joint Exhibit 7-G.

Graph running from the year 1938 through the year 1941, showing the long position of petitioner at any
299 given time as against the so-called sales commitments.

(PHOTOPRINTS.)

[*For the Convenience of Court and Counsel This Exhibit (Photostatic Copies) Is Bound in on the Opposite Page.*]

300

Corn Products Refining Co. — 1938

[Jnw Exhibit T-C]

JANUARY 5 10 15 20 25 | FEBRUARY 5 10 15 20 25 | MARCH 5 10 15 20 25 | APRIL 5 10 15 20 25 | MAY 5 10 15 20 25 | JUNE 5 10 15 20 25 | JULY 5 10 15 20 25 | AUGUST 5 10 15 20 25 | SEPTEMBER 5 10 15 20 25 | OCTOBER 5 10 15 20 25 | NOVEMBER 5 10 15 20 25 | DECEMBER 5 10 15 20 25

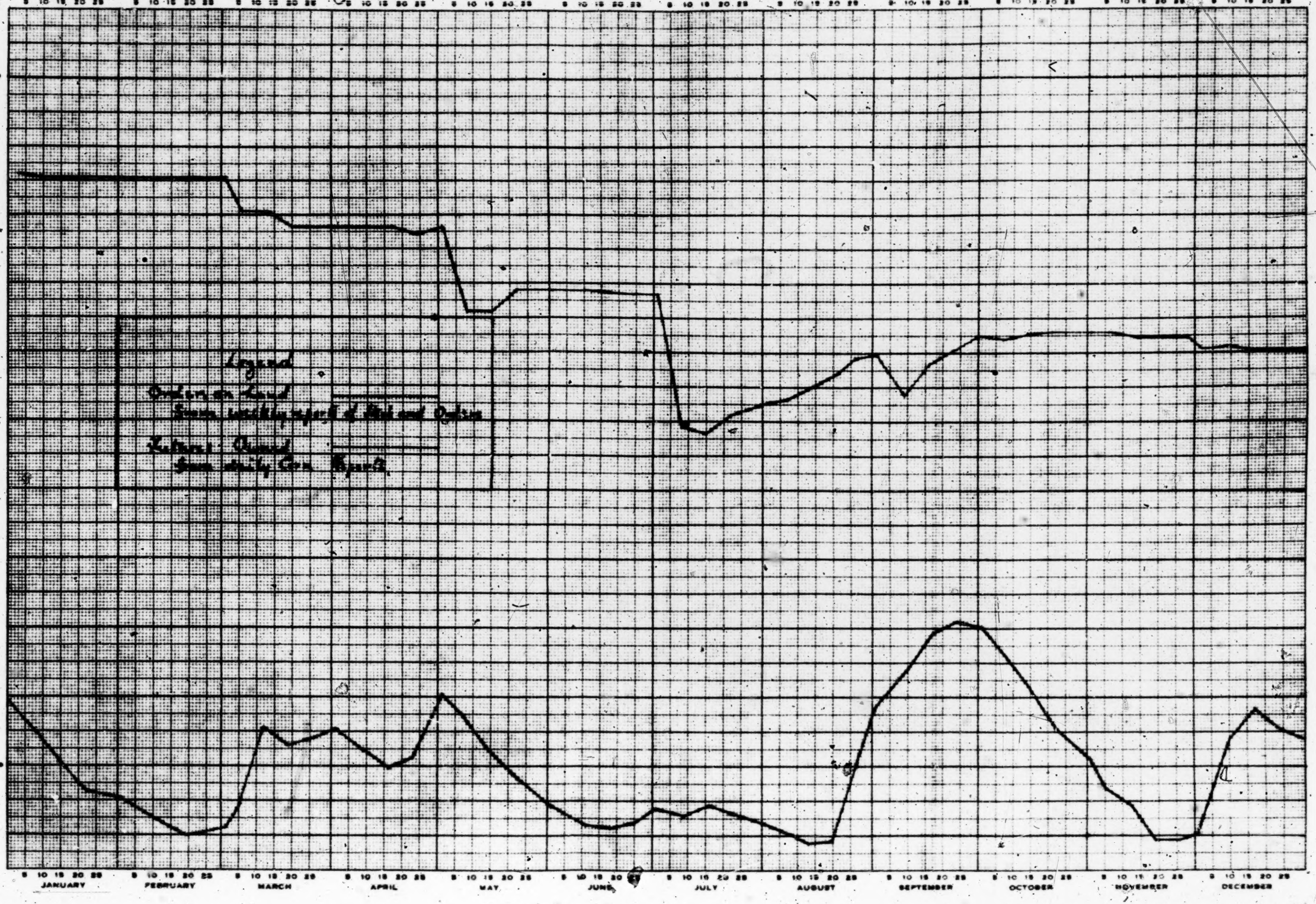
THE TAX COURT OF THE [illegible]
JUN 13 [illegible]
[illegible] 76

Legend
Orders on hand — from weekly reports of Steel and Iron
Production Curve — from daily Corn Report

JANUARY 5 10 15 20 25 | FEBRUARY 5 10 15 20 25 | MARCH 5 10 15 20 25 | APRIL 5 10 15 20 25 | MAY 5 10 15 20 25 | JUNE 5 10 15 20 25 | JULY 5 10 15 20 25 | AUGUST 5 10 15 20 25 | SEPTEMBER 5 10 15 20 25 | OCTOBER 5 10 15 20 25 | NOVEMBER 5 10 15 20 25 | DECEMBER 5 10 15 20 25

A-1

Corn Products Refining Co. ~ 1939



Corn Products Refining Co — 1940

Bushels

12,000,000
11,000,000
10,000,000
9,000,000
8,000,000
7,000,000
6,000,000

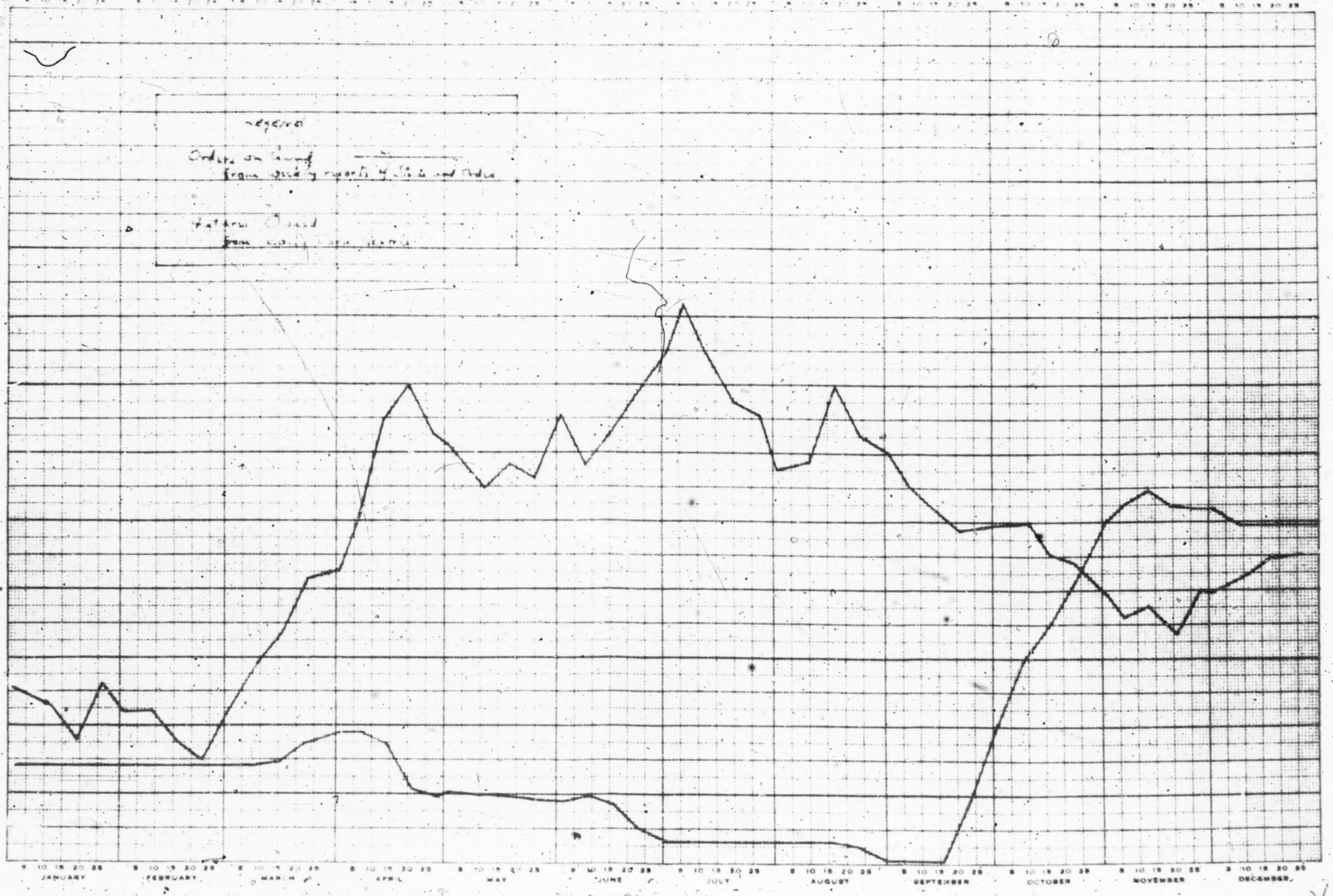
JANUARY 5 10 15 20 25
FEBRUARY 5 10 15 20 25
MARCH 5 10 15 20 25
APRIL 5 10 15 20 25
MAY 5 10 15 20 25
JUNE 5 10 15 20 25
JULY 5 10 15 20 25
AUGUST 5 10 15 20 25
SEPTEMBER 5 10 15 20 25
OCTOBER 5 10 15 20 25
NOVEMBER 5 10 15 20 25
DECEMBER 5 10 15 20 25

Legend

Duplicate on hand
from weekly report of Stock Clerk

Visible Supply
from daily Corn Reports

Cora Production Refining Co. — 1921



N-4

304

Petitioner's Exhibit 8.

Forms of Commodity Exchange Authority and of Food Distribution Administration.

305

(PHOTOPRINTS.)

[*For the Convenience of Court and Counsel This Exhibit (Photostatic Copies) Is Bound in on the Opposite Page.*]

306

Form 304 C. E. 2.

UNITED STATES DEPARTMENT OF AGRICULTURE
COMMODITY EXCHANGE ADMINISTRATION

SEE OTHER SIDE FOR INSTRUCTIONS

Report of _____ (Firm number) as of the close of business on Friday* _____ (Month) (Day) (Year)

WEEKLY STATEMENT OF POSITIONS IN CASH GRAIN AND GRAIN FUTURES

(Thousands of bushels, i. e., 000 omitted. Products and byproducts in terms of grain)

PART I.—CASH-GRAIN POSITION

PART II.—MAKE-UP OF CASH-GRAIN POSITION

Grain	Net Long (1)	Net Short (2)	LONG: Stocks Owned — Grain (3)	Stocks Owned — Products (4)	Stocks Owned — Byproducts (5)**	LONG: Purchase Commitments — Grain (6)	Purchase Commitments — Products (7)	Purchase Commitments — Byproducts (8)	Total Long (9)	SHORT: Sale Commitments — Grain (10)	Sale Commitments — Products (11)	Sale Commitments — Byproducts (12)	Total Short (13)
Wheat													
Corn													
Oats													
Rye													
Barley													
Flaxseed													

PART III.—GRAIN-FUTURES POSITION

Months	Del. Mo.	Wheat Long	Wheat Short	Corn Long	Corn Short	Oats Long	Oats Short	Rye Long	Rye Short	Barley Long	Barley Short	Flaxseed Long	Flaxseed Short
Totals													
Net position in grain hands													

*If Friday is a holiday the report should be made as of the close of business on the last preceding business day.

THE TAX COURT OF THE U.S.
DIV. 2 DOCKET 20399
JUN 13 1950
PETITIONER'S EXHIBIT 8
RESPONDENT'S

Petitioner's Exhibit 8.

INSTRUCTIONS FOR PREPARING AND FILING WEEKLY REPORTS ON ~~FOCM~~ 204 SHOWING POSITIONS IN CASH GRAIN AND GRAIN FUTURES

(See Rules and Regulations under the Commodity Exchange Act)

Persons required to file reports on Form 204.—Every person (individual, association, partnership, corporation, or trust), who is engaged in merchandising, processing, or dealing in, grain or grain products and who holds or controls open contracts in any *one* future of any grain on any contract market, which equal or exceed the amount fixed by the Secretary of Agriculture under authority of section 4i (2) of the Commodity Exchange Act, must report *each week* to the Commodity Exchange Administration on Form 204.

Time of filing.—Reports required on Form 204 must be filed with the Commodity Exchange Administration as soon as possible after the close of business on *Friday* of each week and in any event not later than the close of business on the following business day: *Provided*, That reports may be transmitted by mail, in accordance with instructions furnished by the Commodity Exchange Administration, if mailed not later than midnight of the following business day.

Code.—Use code number assigned to you by the Commodity Exchange Administration; do not use name.

Date.—Show *year* as well as month and day.

Quantities.—Show all quantities in thousands of bushels, that is, "000" omitted. Show grain products and byproducts in terms of grain.

Information required.—Each report on Form 204 must contain the following information with respect to each grain in which you hold or control open contracts in any *one* future thereof on (or subject to the rules of) any contract market equal to or in excess of the amount fixed by the Secretary of Agriculture under authority of section 4i (2) of the Commodity Exchange Act:

(*a*) The amount of your net long or net short cash-grain position in such grain (part I of Form 204).

(*b*) The make-up of your cash-grain position showing (1) the amount of stocks of such grain or products or byproducts thereof, (2) the amount of purchase commitments open in such grain or products or byproducts thereof, and (3) the amount of sale commitments open in such grain or products or byproducts thereof (part II of Form 204). The difference between the amounts shown in columns (9) and (13), with respect to each cash grain reported, must agree with the net position in each such grain shown in part I.

(*c*) Statement showing the amount of your open contracts in all futures of such grain, by markets and by delivery months (part III of Form 204).

Determining cash-grain position.—Your cash-grain position should be determined according to standards and conversion factors applying to products and byproducts usual and common to the business in which you are engaged. If, in determining your cash-grain position for hedging purposes, it be your practice regularly to exclude certain products or byproducts, such products and byproducts should be excluded in reporting your cash-grain position on Form 204.

Report Form 300 C. R. B.
Public Law 272

UNITED STATES DEPARTMENT OF AGRICULTURE
FOOD DISTRIBUTION ADMINISTRATION
COMPLIANCE BRANCH

Bureau Bureau No. [illegible]
Approval expires 1-31-45

Report of _____ as of the close of the market on _____ (Month) _____ (Day) _____ (Year)
(Code number)

STATEMENT OF _____ FUTURES PURCHASES AND SALES, DELIVERIES, OPEN CONTRACTS, ETC., ON, OR SUBJECT TO THE RULES OF, ANY BOARD OF TRADE
(Specify grain)

(REPORT ONE GRAIN ONLY ON THIS SHEET—SEE OTHER SIDE FOR INSTRUCTIONS)

(*Thousands of bushels, i. e., 000 omitted*)

Market	Month of Delivery	Trades and Deliveries: Purchases and Sales: Bought	Trades and Deliveries: Purchases and Sales: Sold	Trades and Deliveries: Deliveries: Delivered	Trades and Deliveries: Deliveries: Received	Open Contracts: Speculative: Long	Open Contracts: Speculative: Short	Open Contracts: Spreading: Long	Open Contracts: Spreading: Short	Open Contracts: Hedging: Long	Open Contracts: Hedging: Short	Open Contracts: Total: Long	Open Contracts: Total: Short
Chicago Board of Trade	May												
	July												
	Sept												
	Dec												
	Total												
Minneapolis Chamber of Commerce	May												
	July												
	Sept												
	Dec												
	Total												
Kansas City Board of Trade	May												
	July												
	Sept												
	Dec												
	Total												
	May												
	July												
	Sept												
	Dec												
	Total												
Kansas City Board of Trade	May												
	July												
	Sept												
	Dec												
	Total												
	May												
	July												
	Sept												
	Dec												
	Total												
Total—All markets													

(TRANSFERS, EXCHANGE OF FUTURES FOR CASH, OR CORRECTIONS OF PREVIOUS REPORTS)

Note.—The word "grain" as used herein means and includes wheat, corn, oats, barley, rye, rice, flaxseed, grain sorghums, and soybeans

INSTRUCTIONS FOR THE PREPARATION AND FILING OF REPORTS ON FORM 203 BY PERSONS HOLDING OR CONTROLLING OPEN CONTRACTS IN ANY ONE FUTURE OF ANY GRAIN EQUAL TO OR EXCEEDING THE AMOUNT FIXED BY THE SECRETARY OF AGRICULTURE UNDER SECTION 4i (2) OF THE COMMODITY EXCHANGE ACT

(See Rules and Regulations Under the Commodity Exchange Act)

BY WHOM FILED.—Every person who either holds or controls *open contracts* in any *one* future of any grain on any one contract market—resulting from transactions made on or subject to the rules of such contract market—which equal or exceed the amount fixed by the Secretary of Agriculture under section 4i (2) of the Commodity Exchange Act is required to report to the Compliance Branch, Food Distribution Administration, on Form 203. Such person must also file a report on this form covering the first day on which his open contracts in such future fall below such amount.

FREQUENCY.—Daily reports are required. However, if on any day you have *no trades or transactions* in any future of a grain previously reported—and there has been no change in your open contracts in any future of such grain—a new report need not be made. In such case the last detailed report filed by you shall be considered as the required report on open contracts on all intervening days.

TIME OF FILING.—Reports required on Form 203 must be filed with the Compliance Branch, Food Distribution Administration, as soon as possible after the close of business *on the day covered by the report* and in any event not later than 9 a. m. on the next following business day: *Provided*, That reports may be transmitted by mail, in accordance with instructions furnished by the Compliance Branch, Food Distribution Administration, if postmarked *not later than midnight* of the day covered by the report.

DATE.—Show *year* as well as month and day.

CODE NUMBER.—After you file your first report on Form 203, or upon application in advance to the Compliance Branch, Food Distribution Administration, you will be given a code number. Use this code number on all reports on Form 203 filed thereafter; do not use name.

QUANTITIES.—Show all quantities in *thousands of bushels*, that is, "000" omitted.

INFORMATION REQUIRED.—Separate reports on Form 203 must be filed covering each grain in which you hold or control open contracts in any one future equal to or exceeding the amount fixed by the Secretary of Agriculture. Each such report on Form 203 must show, by markets and by futures, for the day covered thereby:

(*a*) The amount of such grain bought and the amount sold by you for future delivery on all boards of trade (exchanges).

(*b*) The amount of such grain delivered by you, or received by you, in settlement of futures contracts on all boards of trade (exchanges).

(*c*) The amount of open contracts held or controlled by you *at the close of the day*, classified as to character, i. e., whether speculative, spreading, or hedging, in all futures of such grain on all boards of trade (exchanges). These figures should reconcile with the open contracts shown on the last preceding report.

METHOD OF REPORTING TRADES AND DELIVERIES.—Purchases and sales should be reported as of the date of execution. Deliveries made or received should be reported as of the day on which delivery is finally consummated.

310 **Petitioner's Exhibit 9.**

1940

Yearly average yields (all plants) from commercial corn (#2 Basis)

Their values at prices prevailing June 1—Chicago basis.

Pearl Starch in bags	63.31# @ $ 2.80 — 100# =	$ 1.773
Gluten Feed in bulk	27.13# @ $18.00 Ton =	.244
Oil	3.14# @ $ 5.00 — 100# =	.157

* * * * * *

311 Yearly average cost of corn ground (#2 Basis)

Argo	= Per 100#	$ 1.126
All Plants	= Per 100#	$ 1.115

Comparative yields, Argo Plant only.

Starch	63.22#
Feeds	27.23
Oil	3.13

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312 **Petitioner's Exhibit 10.**

Standard contract.

(PHOTOPRINT.)

[*For the Convenience of Court and Counsel This Exhibit (Photostatic Copy) Is Bound in on the Opposite Page.*]

FORM 823

C. P. S. NO. _____

CORN PRODUCTS SALES COMPANY

WHITEHALL BUILDING
17 BATTERY PLACE
NEW YORK

Date _____

New Business _____

Confirming Wire _____

Trade No. _____

Customers Order No. _____

Brokers No. _____

Dear Sir

We are in receipt of your order through _____ for

THE TAX COURT OF THE U.S.
DIV. 3 DOCKET 20399
ADMITTED IN EVIDENCE
JUN 13 1950
PETITIONER'S EXHIBIT 10
RESPONDENT'S

which is hereby confirmed upon the following terms and conditions

Deliveries to be made as ordered subject to Seller's approval of Buyer's credit, before each shipment.

SHIPMENT F O B cars at point of shipment freight prepaid in (carlots) to be made within 30 days from date of sale, unless otherwise stated above.

SHIPPING INSTRUCTIONS To be furnished by Buyer within 10 days from date of sale and if not so furnished Seller has the option of making shipment within contract period, or to cancel contract without notice.

PAYMENT 2% 10 days in New York or Chicago exchange due at Seller's New York Office within 10 days from date of invoice; 30 days net

If at any time before delivery the financial responsibility of the Buyer becomes impaired or unsatisfactory to the Seller, or Buyer should have failed to make payment for previous shipment in accordance with terms of sale, Seller may cancel any unshipped portion of the contract or require cash payment or satisfactory security before further shipment is made.

DELAYS IN SHIPMENT Seller shall in no case be held responsible for demurrage or storage charges at destination or for any damages arising from delayed shipments caused by strikes, accidents, car shortage, inability to produce supplies or interruptions of manufacture beyond its control, but if shipment is delayed beyond 10 days through Seller's default, Buyer is entitled to any lower market price of Seller in effect on date of shipment or Buyer may cancel delayed order by telegram or letter, provided same is received by the Seller before shipment of such order, otherwise order remains uncancelled.

ROUTING Seller reserves the right to ship from any factory or point and select the routing. Every effort will be made to respect Buyer's wishes as to delivery lines where substantial reason is given. Buyer assumes risk of leakage and damage after delivery to carrier in good condition. Where shortage or damage is apparent on arrival, Buyer should always receipt for goods to the transportation company in damaged condition and notify Seller immediately.

No sales are binding upon this company until accepted in writing at the principal office of Seller in New York. Salesmen and local brokers are not empowered to execute or modify contracts for Seller.

The prepaid price herein named is subject to change either up or down, according to any advance or decline in the freight rate on any portion not shipped at the time such rate change becomes effective.

Seller not to be responsible for the adaptability of the goods to be delivered on this contract for any specific purpose unless specially and separately provided for in this contract.

Any duty, excise or other tax or charge, Federal, State or Municipal, hereafter imposed on the products covered hereby, or its manufacture, refining or sale, shall be added to the price herein specified.

If our regular market price on date of arrival in your market of any shipment against this contract is lower than price at which such shipments are invoiced, you will have the benefit of such lower price.

It is agreed that the goods sold under this contract are for consumption in the United States only and not for export.

Respectfully yours,

CORN PRODUCTS SALES COMPANY

Per _____

THE TAX COURT OF THE U.S.
DIV. 3 DOCKET 20399
ADMITTED IN EVIDENCE
JUN 13 1950
PETITIONER'S EXHIBIT 10
RESPONDENT'S

which is hereby confirmed upon the following terms and conditions

Deliveries to be made as ordered subject to Seller's approval of Buyer's credit, before each shipment.

SHIPMENT F O B cars at point of shipment freight prepaid in (carlots) to be made within 30 days from date of sale, unless otherwise stated above.

SHIPPING INSTRUCTIONS To be furnished by Buyer within 10 days from date of sale and if not so furnished Seller has the option of making shipment within contract period, or to cancel contract without notice.

PAYMENT 2% 10 days in New York or Chicago exchange due at Seller's New York Office within 10 days from date of invoice; 30 days net

If at any time before delivery the financial responsibility of the Buyer becomes impaired or unsatisfactory to the Seller, or Buyer should have failed to make payment for previous shipment in accordance with terms of sale, Seller may cancel any unshipped portion of the contract or require cash payment or satisfactory security before further shipment is made.

DELAYS IN SHIPMENT Seller shall in no case be held responsible for demurrage or storage charges at destination or for any damages arising from delayed shipments caused by strikes, accidents, car shortage, inability to produce supplies or interruptions of manufacture beyond its control, but if shipment is delayed beyond 10 days through Seller's default, Buyer is entitled to any lower market price of Seller in effect on date of shipment or Buyer may cancel delayed order by telegram or letter, provided same is received by the Seller before shipment of such order, otherwise order remains uncancelled.

ROUTING Seller reserves the right to ship from any factory or point and select the routing. Every effort will be made to respect Buyer's wishes as to delivery lines where substantial reason is given. Buyer assumes risk of leakage and damage after delivery to carrier in good condition. Where shortage or damage is apparent on arrival, Buyer should always receipt for goods to the transportation company in damaged condition and notify Seller immediately.

No sales are binding upon this company until accepted in writing at the principal office of Seller in New York. Salesmen and local brokers are not empowered to execute or modify contracts for Seller.

The prepaid price herein named is subject to change either up or down, according to any advance or decline in the freight rate on any portion not shipped at the time such rate change becomes effective.

Seller not to be responsible for the adaptability of the goods to be delivered on this contract for any specific purpose unless specially and separately provided for in this contract.

Any duty, excise or other tax or charge, Federal, State or Municipal, hereafter imposed on the products covered hereby, or its manufacture, refining or sale, shall be added to the price herein specified.

If our regular market price on date of arrival in your market of any shipment against this contract is lower than price at which such shipments are invoiced, you will have the benefit of such lower price.

It is agreed that the goods sold under this contract are for consumption in the United States only and not for export.

Respectfully yours,

CORN PRODUCTS SALES COMPANY

Per _____

Petitioner's Exhibit 10.

316 **Petitioner's Exhibit 11.**

AGREEMENT made this 21st day of April 1927 between CORN PRODUCTS REFINING COMPANY, a New Jersey corporation, hereinafter called "Seller", party of the first part, and HURON MILLING COMPANY, a corporation of Michigan, hereinafter called "Buyer", party of the second part:

Whereas, the Buyer is a producer of various starches made from wheat, corn, and other raw materials, and in the conduct of its business has developed certain formulae and methods for the manufacture of certain specialties from such starches and believes that because of the com-
317 paratively limited capacity and disadvantageous location of its plant at Harbor Beach, Mich. it would be better enabled to substantially increase its business and more successfully meet the competition of other manufacturers of similar products by purchasing its corn starch requirements from one of the substantial producers of that commodity, and

Whereas, the Seller is a substantial producer of corn starch and has facilities, equipment, and economies of operation far superior to those of the Buyer for the manu-
318 facture and shipment of all the corn starches and specialties made therefrom which are produced by the Buyer and is willing to supply the Buyer with its requirements of the products covered by this contract at the price and upon the terms hereinafter provided;

NOW, THEREFORE, in consideration of the premises the parties hereto do hereby agree as follows:

1. *Quantity.* Seller agrees to manufacture and sell to Buyer or on its order, and Buyer agrees to purchase from Seller, Buyer's entire requirements of thin boiling pearl, chlorinated and other special starches, including Hercules

gum, up to a maximum of Thirty Million (30,000,000) 319
pounds per annum during the term of this agreement; provided, however, that the term "Buyer's requirements" as used herein shall not be construed to include any thin boiling starch which may be manufactured by Buyer from corn ground in its own plant.

2. *Quality.* Such of the foregoing products as are now manufactured by Seller shall be its usual standard quality; other products to be manufactured by Seller hereunder shall be made according to and in compliance with specifications, formulae, and manufacturing methods therefor 320
to be furnished by Buyer.

3. *Shipments.* To destinations as ordered by Buyer.

4. *Deliveries.* F. O. B. cars at any of Seller's factories at Seller's option, freight adjusted to Chicago basis. In case of shipment in mixed cars with other products of Seller, Buyer to be charged proportionate cost of actual freight, cartage, and warehousing.

5. *Price.* To be calculated on an estimated base price of $1.80 per one hundred pounds for thick boiling pearl starch (12% moisture) f. o. b., cars, Chicago, in bulk, when 321
Seller's

> cost of corn at Argo (16% moisture) is 70¢ per bushel; price for feed (Chicago) is $28 per short ton; and price of crude corn oil (Chicago) is $8.00 per 100 pounds.
>
> Such base price of thick boiling pearl starch shall be increased at the rate of 3¢ per 100 pounds for each 1¢ per bushel increase in Seller's cost of corn, and decreased at the same rate per 100 pounds for decrease of 1¢ per bushel in such cost of corn.

Petitioner's Exhibit 11.

322 Such estimated cost price for thick boiling pearl starch shall also be increased at the rate of 2¢ per 100 pounds for each decrease of $1.00 per ton in Seller's Chicago price for feed, and decreased at the rate of 2¢ per 100 pounds for each increase of $1.00 per ton in Seller's Chicago price for feed.

Such base price of thick boiling pearl starch shall also be decreased at the rate of 4¢ per 100 pounds for each increase of 1¢ per pound in Seller's price for crude corn oil, and increased at the rate of 4¢ per 100 pounds for each decrease of 1¢ per pound

323 in such price of crude corn oil.

Such estimated base price of thick boiling pearl starch shall also be adjusted up or down with each corresponding increase or decrease of 10¢ per 100 pounds finished product in Seller's cost of coal, which is normally $3.00 per ton, and/or labor, which is normally 60¢ per hour in Seller's wet starch house. These adjustments to be at the rate of 5¢ per 100 pounds of starch for each $1.00 increase or decrease per ton of coal, and at the rate of 1¢ per 100 pounds of starch for each 2¢ per hour increase or decrease in cost of labor.

324 In case finished product analyzes starch of greater or less than 12% moisture, estimated base price of thick boiling starch to be adjusted accordingly. The estimated base price of thick boiling pearl starch (12% moisture) shall, however, never exceed Seller's average monthly net market price for such product, exclusive of packages.

All bags, barrels, cartons, packages, etc. to be added at cost plus actual packing cost.

Buyer agrees to pay Seller for all products manufactured hereunder and delivered to Buyer, or on its order,

the following differentials over the base price of thick boiling pearl starch as above estimated, as follows: 325

Thin boiling pearl starch (12% moisture) 35% per 100 pounds.

Thick or thin crystal starches, either machine or hand packed, 45¢ per 100 pounds.

Large crystals requiring about two weeks to manufacture 55¢ per 100 pounds.

Hercules gum and chlorinated starches at a differential above price of thin boiling pearl to be established and based upon Seller's difference in cost of manufacture between such products.

326

6. In case Buyer's requirements of thin boiling and chlorinated starches shall be in excess of 30,000,000 pounds per annum because of its sales of Hercules gum exceeding 10,000,000 pounds per annum, Seller agrees to manufacture and sell to Buyer an additional quantity of Hercules gum up to a maximum of 10,000,000 pounds per annum at a differential over the base price of thick boiling pearl starch as fixed and adjusted in Paragraph 15 hereof corresponding to the differential above the price for thin boiling pearl starch then in effect for Hercules gum under Paragraph 5 hereof, or to deliver to Buyer a sufficient quantity of thick boiling pearl starch for the manufacture 327
of such excess quantity of Hercules gum at the estimated base price for thick boiling pearl starch as provided in Paragraph 5 hereof, and subject to the same adjustments as therein specified.

7. In case Buyer desires to manufacture any thin boiling or chlorinated starches at its plant at Harbor Beach, Mich., Seller agrees to deliver to Buyer up to a maximum of Five Million (5,000,000) pounds per annum of thick boiling pearl starch of Seller's normal standard quality at

Petitioner's Exhibit 11.

328 Seller's estimated base price for thick boiling pearl starch as fixed and subject to the adjustments as specified in Paragraph 5 hereof.

8. In the event that Buyer shall satisfy Seller that competition of other manufacturers has forced Buyer to sell any of such special starches during any calendar month at prices which shall average less than 15¢ per 100 pounds over the price charged by Seller for such product hereunder during such month, Seller shall reduce its price on such products to such sum as shall equal 15¢ per 100 pounds under Buyer's average selling price obtained there-
329 for during such month, provided, however, that Seller shall not be required to make any reduction which would bring its selling price for such products more than 30¢ per 100 pounds under a sum equal to the base estimated price of thick boiling pearl starch, plus the differential applicable to such product hereunder.

9. *Inspection.* All special starches manufactured by Seller under formulae, processes, or manufacturing methods supplied by Buyer shall be made under the supervision of a representative of Buyer who shall at all times be given
330 free access to Seller's plant for such propose and authorized to approve the quality of such products before delivery. Such inspection and approval shall not, however, relieve Seller from responsibility for defects or inferior quality in any of such products not discoverable by ordinary inspection and/or due to the failure of Seller to accurately follow the instructions for the manufacture thereof given by Buyer.

10. It is understood that the secret specifications, formulae, and manufacturing methods which shall be disclosed to Seller by Buyer, in carrying out the provisions of this contract, are the exclusive property of Buyer and that

Petitioner's Exhibit 11.

Seller will not use any of such specifications, formulae, or manufacturing methods, either directly or indirectly, in the manufacture of any of such products for itself or for others, nor disclosed any thereof to any other person, firm, or corporation and that this clause of this agreement shall be binding during the term of this contract and after the termination thereof. Provided, however, that nothing herein contained shall be construed to prevent Seller from manufacturing and selling similar products under any formulae, processes, or methods which it may now own or which may become commonly known or be acquired from others, or from using similarly made products as an ingredient in or base material for the manufacture of other products not now made by Buyer. 331 332

11. Seller agrees to manufacture and hold in ~~stock~~ reasonable quantities of the products to be made by Seller under the specifications, formulae, or manufacturing methods furnished to it by Buyer hereunder. Buyer shall, however, from time to time notify Seller of the quantities of such respective products required to be kept in stock, which total quantities, however, shall at no time exceed two months' normal requirements of special starches and one months' normal requirements of thin boiling. 333

12. Seller shall not be liable for deliveries under this contract in case of strikes, shortage of cars, corn or fuel, or for any other reason beyond its reasonable control, but in case Seller is not able to promptly fill orders for all of its customers Seller agrees to give Buyer equal preference in shipments and fill Buyer's orders as promptly as possible, having due regard to all of Seller's customers.

13. Seller agrees to furnish Buyer monthly statements showing the stocks of products held by Seller for Buyer's account on the last day of each preceding month.

Petitioner's Exhibit 11.

334 14. Seller further agrees to sell to Buyer and Buyer agrees to purchase from Seller Buyer's entire requirements of ordinary thick boiling pearl and powdered corn starches and edible pearl and powdered starches up to a maximum of Twenty Million (20,000,000) pounds per annum of the usual standard quality manufactured by Seller. Provided, however, that the term "Buyer's requirements", as used herein, shall not be construed to include any thick boiling pearl starch which may be manufactured by Buyer from corn ground in its own plant.

Shipments and deliveries to be made in the same manner
335 as hereinabove provided with respect to thin boiling pearl and other special starches.

15. The price for thick boiling pearl starch, 12% moisture, to be paid by Buyer shall be $2.00 per 100 pounds f. o. b. cars Chicago in bulk when Seller's

cost of corn at Argo (16% moisture) is 70¢ per bushel; price for feed (Chicago) is $28 per short ton; and price of crude corn oil (Chicago) is $8.00 per 100 pounds.

Such base price of thick boiling pearl starch shall be increased at the rate of 3¢ per 100 pounds for
336 each 1¢ per bushel increase in Seller's cost of corn, and decreased at the same rate per 100 pounds for decrease of 1¢ per bushel in such cost of corn.

Such estimated cost price for thick boiling pearl starch shall also be increased at the rate of 2¢ per 100 pounds for each decrease of $1.00 per ton in Seller's Chicago price for feed, and decreased at the rate of 2¢ per 100 pounds for each increase of $1.00 per ton in Seller's Chicago price for feed.

Such base price of thick boiling pearl starch shall also be decreased at the rate of 4¢ per 100 pounds for each increase of 1¢ per pound in Seller's price

Petitioner's Exhibit 11.

for crude corn oil, and increased at the rate of 4¢ per 100 pounds for each decrease of 1¢ per pound in such price of crude corn oil. 337

Such estimated base price of thick boiling pearl starch shall also be adjusted up or down with each corresponding increase or decrease of 10¢ per 100 pounds finished product in Seller's cost of coal, which is normally $3.00 per ton, and/or labor, which is normally 60¢ per hour in Seller's wet starch house. These adjustments to be at the rate of 5¢ per 100 pounds of starch for each $1.00 increase or decrease per ton of coal, and at the rate of 1¢ per 100 pounds of starch for each 2¢ per hour increase or decrease in cost of labor. 338

In case finished product analyzes starch of greater or less than 12% moisture, estimated base price of thick boiling starch to be adjusted accordingly.

Provided, however, that the price to be paid by Buyer hereunder for ordinary thick boiling pearl starch shall at no time be lower than 50¢ per 100 pounds below Seller's net market price for ordinary thick boiling pearl starch in bulk f. o. b. cars Chicago, and no higher than the net market price for ordinary pearl starch. 339

The price for edible pearl, ordinary powdered and edible powdered starches to be paid by Buyer shall exceed the price to be paid for ordinary thick boiling pearl starch as follows:

Edible pearl starch 2½¢
Ordinary powdered starch 10¢
Edible powdered starch 12½¢

Provided, however, that the differential of edible pearl, ordinary powdered, and edible powdered starches over

340 thick boiling pearl starch to be paid by Buyer hereunder shall at no time exceed Seller's current differential between such products in the general market.

16. Thick boiling pearl and powdered and edible starches to be delivered by Seller hereunder are sold for the use of Buyer in its own manufacturing business and not to be sold by it except as the same have been so modified and blended with other products that they have become different in type or working quality; provided, however, that the provisions of this paragraph shall not be applicable to the existing contract between Buyer and the
341 Larkin Company of Buffalo, N. Y. relating to the sale of certain starches, or any similar renewal thereof.

17. For the purpose of determining Seller's cost of corn and price of crude corn oil at Chicago in making adjustments of base price of thick boiling pearl starch under the provisions of this contract shall be determined by the methods customarily used by Seller in the conduct of its business, which methods and the computations used therein shall at all times be open to inspection by a representative of the Buyer.

342 18. All deliveries made by Seller hereunder in any one month shall be invoiced to Buyer on the fifteenth day of the succeeding month, and paid for by Buyer within ten days from receipt of invoice.

19. This contract shall not be assignable by either party without the consent of the other.

20. This contract shall commence on the day of 1927, and continue for the term of fifteen (15) years, and at the option of Buyer, to be exercised by giving written notice thereof to Seller on or before December

Petitioner's Exhibit 11.

31st, 1940, may be extended for an additional period of ten (10) years, making twenty-five (25) in all. 343

IN WITNESS WHEREOF the parties hereto have caused these presents to be duly executed the day and year first above written.

CORN PRODUCTS REFINING COMPANY
By E. T. Bedford
President

F. T. FISHER
Secretary

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HURON MILLING COMPANY
By Geo. J. Jenks
President

J. C. JENKS
Secretary

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UNITED STATES 1940

RETURN OF INFORMATION AND AUTHORIZATION AND CONSENT OF SUBSIDIARY CORPORATION INCLUDED IN A CONSOLIDATED INCOME TAX RETURN OF RAILROAD CORPORATIONS OR PAN-AMERICAN TRADE CORPORATIONS

For Calendar Year 1940

Refinacoes de Milho
Caixa Postal #2972
Sao Paulo, Brazil

347 (1) Date incorporated November 16, 1928 Under laws of State of New Jersey

(2) Capital stock outstanding at beginning of taxable year: (*a*) Com., $100,000.

(3) Kind of business Manufacture of products from corn Active or inactive Active.

(4) Name of common parent corporation Corn Products Refining Company

(5) Address of common parent corporation 17 Battery Place, New York, N. Y.

(6) Internal revenue district in which consolidated return is filed. 2nd—New York

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Joint Exhibit 12-H.

UNITED STATES 1940 349
CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS, AND DEFENSE

TAX RETURN

For Calendar Year 1940

Corn Products Refining Company and
Refinacoes de Milho Consolidated Return
17 Battery Place
New York New York New York

Kind of business: Manufacture of products made from corn.

NORMAL-TAX NET INCOME COMPUTATION

Item No.	GROSS INCOME		350
1.	Gross sales (where inventories are an income-determining factor) $64,880,927.95 Less: Returns and allowances $9,455,212.87	$55,425,715.08	
2.	Less: Cost of goods sold. (From Schedule A)	37,228,672.72	
3.	Gross profit from sales	$18,197,042.36	
7.	Interest on loans, notes, mortgages, bonds, bank deposits, etc. (See Instruction 17-(1))	245,135.77	
8.	Interest on obligations of the United States. (From Schedule M, line 15-(*a*) (4).) (See Instruction 17-(2))	2,629.69	
10.	Royalties. (See Instruction 19)	383,272.84	351
11.	(*b*) Net long-term capital gain (or loss). (From Schedule C)	3,903,756.88	
12.	Dividends. (From Schedule E)	2,928,583.54	
13.	Other income. (State nature)	87,555.04	
14.	Total income in items 3, and 6 to 13, inclusive		$17,940,462.36

DEDUCTIONS

15.	Compensation of officers. (From Schedule F)	$ 522,600.00
16.	Salaries and wages (not deducted elsewhere)	1,995,673.26
17.	Rent. (See Instruction 21)	84,413.54

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352	18.	Repairs. (See Instruction 22)	2,027,442.95	
	19.	Bad debts. (From Schedule G)	1,779.03	
	20.	Interest. (See Instruction 24)	4,265.75	
	21.	Taxes. (From Schedule H.) (Report declared value excess-profits tax as item 31)	980,613.60	
	22.	Contributions or gifts paid. (From Schedule I)	9,280.00	
	24.	Depreciation. (From Schedule J)	1,512,331.80	
	27.	Amortization. (Submit schedule; see Instruction 31)	882.68	
353	28.	Other deductions authorized by law. (From Schedule K)	2,055,823.13	
	29.	Total deductions in items 15 to 28, inclusive		9,195,105.74
	30.	Net income for declared value excess-profits tax computation (item 14 minus item 29)		$ 8,745,356.62
	31.	Less: Declared value excess-profits tax. (See Instruction 33)		None
	32.	Net income		$ 8,745,356.62
	33.	Less: Interest on obligations of the United States (item 8 above)		2,629.69
354	34.	Adjusted net income		$ 8,742,726.93
	35.	Less: Dividends received credit (85 percent of column 2, Schedule E, but not in excess of 85 percent of item 34, above)		1,042,317.54
	36.	Normal-tax net income		$ 7,700,409.39

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TOTAL INCOME, DECLARED VALUE EXCESS-PROFITS, AND DEFENSE TAXES

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37.	Total income and income defense taxes (line 35, page 2)	$ 1,848,098.26	
38.	Less: Credit for income taxes paid to a foreign country or United States possession allowed a domestic corporation. (See Instruction 37)	252,218.66	
39.	Balance of income and income defense taxes		$ 1,595,879.60
40.	Total declared value excess-profits and declared value excess-profits defense taxes (line 10, page 2)		None
41.	Total income, declared value excess-profits, and defense taxes due		$ 1,595,879.60

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DECLARED VALUE EXCESS-PROFITS AND DECLARED VALUE EXCESS-PROFITS DEFENSE TAX COMPUTATION. (See Instruction 7)

1.	Net income for declared value excess-profits tax computation (item 30, page 1)	$ 8,745,356.62	
2.	Value of capital stock as declared in your capital stock return for the year ended June 30, 1940 (or for year ended June 30, 1941, if your income tax fiscal year began in 1940 and ended on or after July 31, 1941)		
	C.P.R.–$137,445,630.—		
	$ R.D.M. 479,765.—		
3.	10 per cent of line 2	$13,792,539.30	
4.	Dividends received credit (85 percent of column 2, Schedule E, but not in excess of 85 percent of item 34, page 1)	1,042,317.54	14,834,857.04
5.	Balance subject to declared-value excess-profits tax (line 1 minus total of lines 3 and 4)		$ None
10.	Total declared value excess-profits and declared value excess-profits defense taxes		$ None

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358 CORPORATIONS WITH NORMAL-TAX NET INCOMES OF $38,565.89 OR MORE. (See Instruction 35-(1))

22.	Normal-tax net income (item 36, page 1)	$ 7,700,409.39	
23.	Income tax (22.1 percent of line 22)		$ 1,701,790.48
24.	Income defense tax (1.9 percent of line 22)		$ 146,307.78
33.	Total income tax (line 15, 20, 23, 26, or 1, above, whichever is applicable)		$ 1,701,790.48
34.	Total income defense tax (line 16, 21(*a*), 21 (*b*), 24, 27, or 32, above, whichever is applicable)		146,307.78
359 35.	Total income and income defense taxes		$ 1,848,098.26

Schedule A.—COST OF GOODS SOLD. (See Instruction 16)

(Where inventories are an income-determining factor)

Schedule Attached

Schedule C.—CAPITAL GAINS AND LOSSES. (See Instruction 20)

Schedule Attached

Schedule E.—INCOME FROM DIVIDENDS

Schedule Attached

Schedule G.—BAD DEBTS. (See Instruction 23) (See note 1)

360

1. Taxable year	2. Net Income Reported	3. Sales on Account	4. Bad Debts Charged Off by Corporation if No Reserve is Carried on Books (See note 2)
1940. (See note 2)	$8,745,356.62	$64,880,927.95	$1,779.03

1. Check whether deduction claimed represents worthless debts charged off ☒, or is an addition to a reserve ☐.

Schedule H.—TAXES. (See Instruction 25)

Schedule Attached

Schedule I.—CONTRIBUTIONS OR GIFTS PAID. (See Instruction 26)

Schedule Attached

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Schedule J.—Depreciation. (See Instruction 28) 361

Schedules attached

Schedule K.—Other Deductions. (See Instructions 32)

Schedules attached

Questions

1. Date of incorporation C.P.R. Co—February 6, 1906 Ref. de Milho November 16, 1928

2. State or country New Jersey (both companies)

3. State collector's office where the corporation's return for the preceding year was filed 2nd New York (both companies) 362

4. The corporation's books are in care of W. D. Braidwood Comptroller Located at 17 Battery Place, New York, N. Y.

7. Is the corporation a personal holding company within the meaning of section 501 of the Internal Revenue Code? No

8. Is this a consolidated return of railroad corporations or Pan-American trade corporations? Yes

9. If this is not a consolidated return of railroad corporations of Pan-American trade corporations, (*a*) did you own at any time during the taxable year 50 percent or more of the voting stock of another corporation either domestic or foreign? Yes; or (*b*) did any corporation, individual, partnership, trust, or association own at any time during the taxable year 50 percent or more of your stock? No

10. Is this return made on the basis of cash receipts and disbursements? No 363
If not, describe fully what other basis or method was used in computing net income Accrual

11. State whether the inventories at the beginning and end of the taxable year were valued at cost, or cost or market, whichever is lower .....
If other basis is used, described fully, state why used, and the date inventory was last reconciled with stock cost or market—whichever is lower

12. Did the corporation make a return of information on Forms 1096 and 1099 for the calendar year 1940 (see Instructions 8–(1))? Yes

13. Did the corporation at any time during the taxable year own directly or indirectly any stock of a foreign corporation? (Answer "yes" or "no") Yes

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364 Schedule L.—Balance Sheets. (See Instruction 13)

Schedule Attached

Schedule M.—Reconciliation of Net Income and Analysis of Earned Surplus and Undivided Profits

Schedule Attached

Excess Profits Tax (Second Revenue Act of 1940).

(See Instructions for Form 1121)

(*a*) Is an excess profits tax return on Form 1121 being filed for the taxable period covered by this return? Yes

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CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO
CONSOLIDATED RETURN
17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS, AND DEFENSE TAX RETURN, 1940

SCHEDULE SHOWING HOLDINGS BY CORN PRODUCTS REFINING COMPANY IN DOMESTIC AFFILIATED COMPANIES

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Name of Corporation.	Address of Corporation	Percentage of Stock Owned	Date Stock was Acquired	Collector's Office in which Return was filed
Bedford Construction Company	New York, New York	100%	1920	2nd New York
Corn Products Sales Company	" "	100%	1921	"
Corn Products Sales Company (A Mass. Trust)	" "	100%	1937	"
Chicago, Peoria and Western Railway	" "	100%	1906	"
Crystal Car Line	" "	100%	1906	"
Hummel and Downing Company	Milwaukee, Wisc.	100%	1920	"
Independent Starch Company	New York, New York	100%	1930	"
The Investment Company	" "	100%	1923	"
National Starch Company	" "	99.56%	1906	"
Refinacoes de Milho (American Corporation)	Brazil	100%	1930	"

Joint Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED RETURN

17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS PROFITS, AND DEFENSE TAX RETURN—1940

SCHEDULE A—COST OF GOODS SOLD

CORN PRODUCTS REFINING COMPANY				
Inventory at beginning of year				4,988,134.25
Material or merchandise bought for sale				23,492,978.87
Salaries and wages—				
Manufacturing expense—Argo	2,932,328.35			
" " —Edgewater	324,400.33			
" " —Pekin	1,311,189.43			
" " —Kansas City	687,378.75			
Argo Can Plant	136,625.29			
Kansas City Can Plant	39,504.38			
Edgewater Can Plant	16,435.59			
Carton and Print Shop	76,506.73			
General expense manufacturing department	304,732.40			
Research and development	225,132.25	6,054,233.50		
Less Repairs transferred to Item #18		1,079,438.11		4,974,795.39
Other Costs per Books				
Manufacturing expense—Argo	2,793,078.25			
" " —Edgewater	137,696.46			
" " —Pekin	1,282,525.65			
" " —Kansas City	659,930.49			
Argo Can Plant	840,429.35			
Kansas City Can Plant	327,242.30			
Edgewater Can Plant	90,734.22			
Carton and Print Shop	340,777.47			
General expense manufacturing department	118,503.67			
Research and development	90,668.53	6,683,566.39		
Less: Repairs transferred to Item #18	948,004.84			
Dep'n " " #24	4,630.14	952,634.98	5,730,931.41	
Packages			4,500,314.33	10,231,245.74
Less: Can Plant Sales			2,050,606.25	
Carton and print shop sales			543,647.78	
Cash discount earned			65,277.13	
Stores adjustment			33,895.24	2,693,426.40 7,537,819.34
				40,393,727.85
Less: Inventory at the end of the year				4,890,885.60
Cost of Goods Sold—Corn Products Refining Company				36,192,842.25
REFINACOES DE MILHO				
Inventory at beginning of the year				76,246.66
Material or merchandise bought for sale				513,165.15
Other costs per Books				
Manufacturing expenses			438,452.15	
Packages			135,541.44	
Dismissal of employees			31.79	
Pension funds			2,985.69	
Royalties			18,974.45	595,985.52
Less cash discount earned				6,964.44 589,021.08
				1,178,432.89
Less: Inventory at end of year				142,602.42
Cost of Goods Sold—Refinacoes de Milho				1,035,830.47
TOTAL—Line 2, page 1 of Return				37,228,672.72

Joint Exhibit 12-H

CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED RETURN

CORN PRODUCTS REFINING COMPANY

17 Battery Place New York, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN 1940

SCHEDULE C—CAPITAL GAINS AND LOSSES

	Short Term Gains and Losses	Date Acquired	Date Sold or Called	Cost	Amount Received	Profit or Loss
250 M	Commercial Credit Company	7/25/40	10/23/40	249,687.50	249,687.50	
200 M	Commercial Credit Notes due 9/6/40	4/1/40	9/5/40	199,561.11	199,561.11	
5 M	County of Newcastle, Delaware	11/20/39	6/1/40	5,105.83	5,000.00	105.83
20 M	New Orleans, Texas & Mexico 5's due 1935	6/19/39 to 9/26/39	3/26/40	500.00	500.00	
68 M	New Orleans, Texas & Mexico 5's due 1954	5/4/39 to 9/7/39	3/26/40	1,700.00	1,700.00	
35 M	New Orleans, Texas & Mexico 5½'s due 1954	5/25/39 to 9/13/39	3/26/40	962.50	962.50	
46 M	New Orleans, Texas & Mexico 4½'s due 1956	5/3/39 to 8/10/39	3/26/40	1,035.00	1,035.00	
31 M	New Orleans, Texas & Mexico 5's due 1956	5/31/39 to 7/10/39	3/26/40	775.00	775.00	
36 M	Province of Quebec 3's due 7/15/40	8/17/39	7/15/40	36,733.96	36,000.00	733.96
70 M	Twelve Federal Intermediate Credit Banks	9/15/39	2/2/40	70,065.98	70,000.00	65.98
175 M	United States of America 3⅜'s due 1943 (Exchanged)	12/14/39	6/15/40	179,812.50	175,000.00	4,812.50
936 M	Total Short Term Bonds			745,939.38	740,221.11	5,718.27

	Long Term Gains and Losses					
	Bonds					
150 M	Chgo., Milw., St. Paul & Pacific R. R. 5/2000	6/24/28	11/29/40	104,703.40	1,312.46	103,391.00
195 M	Chgo., Milw., St. Paul & Pacific R. R.	3/5/28	11/29/40	186,837.50	7,779.60	179,057.90
56 8/10 M	Chgo., Milw., St. Paul & Pacific R. R.	3/5, 3/28, 3/29, 4/5/28	11/26/40	35,569.90	2,479.43	33,090.47
80 M	Chicago and Northwestern 4¾'s due 1949	11/23/29	11/20/40	80,125.00	711.20	79,413.80
17 M	Denver and Rio Grande Western 5/55	10/4, 10/7/26	11/20/41	9,061.00	169.97	8,891.03
183 M	Denver and Rio Grande Western 5/55	1926 and 1929	12/26/40	161,421.25	1,408.92	160,012.33
88 M	Int. Great Northern 6/52	9/8/24	12/26/40	87,780.00	6,742.32	81,037.68
25 M	State of New York 5's	6/20/38	3/1/40	26,766.24	25,000.00	1,766.24
100 M	P. and R. Coal and Iron 6/49	6/6, 6/7, 6/10/29	12/26/40	95,426.25	3,096.14	92,420.11
94 M	Puerto Rico 2¾'s due Jan. 1	4/21/36	1/3/40	96,159.50	94,000.00	2,159.50
	Prudence Securities Corp.	7/16/37	2/28/40	4,090.28	4,090.28	--
	Stocks					
600 shs.	B. M. T. Preferred Certificates	1/4/26, 11/29/26, 1/30/28	3/11/40	53,245.00	35,922.76	17,322.24
300 "	B. M. T. Preferred Certificates	1/30/28	3/12/40	25,410.00	18,017.63	7,392.37
600 "	B. M. T. Preferred Certificates	2/28/28, 1/5/33	3/11/40	44,157.50	36,147.75	8,009.75
1,800 "	B. M. T. Preferred Certificates	6/12, 6/13, 6/14, 6/15, 7/19, 1933	1/2/40	81,100.00	60,583.72	20,516.28
1,000 "	B. & O. R. R. Co.	6/9/29, 10/25/29, 5/5/30, 5/7/30	12/26/40	116,713.55	3,054.91	113,658.64
200 "	Electric Bond and Share $6 Preferred	12/8/27	5/9/40	21,850.00	13,959.72	7,890.28
5,000 "	Erie 1st Preferred	1/18, 1/20, 1/23, 2/8, 12/17/28	10/23/40	302,887.50	6,087.19	296,800.31
3,000 "	Hecker Products	11/26/29, 6/23/30	12/26/40	121,600.00	20,554.30	101,045.70
1,000 "	International Tel. & Tel.	3/26, 3/27, 5/5, 5/6/30	12/26/40	62,075.00	2,189.95	59,885.05
3,000 "	Lehigh Coal and Nav. Co.	3/21/30	12/26/40	141,312.50	5,994.86	135,317.64
1,000 "	Missouri-Kansas & Texas R. R.	1/2/30	10/17/40	37,062.50	469.97	36,592.53
2,900 "	M. K. & T. Preferred	3/29, 3/30/26,	10/23/40	246,043.69	5,688.27	240,355.42
500 "	M. K. & T. Preferred	2/15, 4/18/27, 2/15,	10/24/40	45,188.41	912.45	44,275.99
3,200 "	M. K. & T. Preferred	10/11/29, 12/30/32	10/25/40	225,692.87	5,439.82	220,253.05
2,600 "	Missouri Pacific Preferred	5/22, 23, 26, 29/30	10/23/40	264,812.50	242.46	264,570.04
100 "	New York, New Haven & Hartford Pref. 10/6, 12/30/27, 11/25/29		10/22/40	10,675.00	29.36	10,645.64
2,100 "	New York, New Haven & Hartford Pref. 10/6, 12/30/27, 11/25/29		10/23/40	334,525.00	922.18	333,602.82
1,800 "	New York, New Haven & Hartford Pref. 10/6, 12/30/27, 11/25/29		10/24/40	200,837.50	460.41	200,377.09
2,600 "	Southern Pacific	11/25/25, 1/25/26, 12/17/26, 6/19/28	12/26/40	277,070.50	19,613.59	257,456.91
100 "	South Porto Rico Sugar	6/8/34	4/20/40	2,907.86	2,884.94	22.92
300 "	South Porto Rico Sugar	6/9/33	4/22/40	8,545.00	8,654.82	109.82
300 "	South Porto Rico Sugar	7/16/34	4/23/40	11,107.50	8,642.32	2,465.18
100 "	South Porto Rico Sugar	7/16/34	4/29/40	3,702.50	2,909.94	792.56
200 "	South Porto Rico Sugar	7/16/34	4/30/40	7,392.50	5,794.88	1,597.62
4,000 "	Western Pacific R. R. Preferred	Prior to 1931	10/17/40	173,812.50	946.09	172,866.41
6,160 "	National Starch Products 1st Preferred	Prior to 12/31/34	2/3/40	615,000.00	538,000.00	77,000.00
	Sale of blocked foreign currency					918,344.05
						1,594,258.25
	Total long term capital loss					3,903,756.88

Joint Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY and REFINACOES DE MILHO CONSOLIDATED RETURN
17 Battery Place New York, New York

CORPORATION INCOME, DECLARED VALUE, EXCESS PROFITS, and DEFENSE TAX RETURN 1940

SCHEDULE E—INCOME FROM DIVIDENDS

NAME and ADDRESS OF CORPORATIONS					
CORN PRODUCTS REFINING COMPANY					
DOMESTIC CORPORATIONS.					
AFFILIATED COMPANIES					
Corn Products Sales Co.	17 Battery Place	New York, N. Y.	350,000.00		
Corn Products Sales Co. (A Mass. Trust)	17 Battery Place	New York, N. Y.	75,250.00		
Investment Company, The	17 Battery Place	New York, N. Y.	50,090.00		
New England Grain Co.	177 Milk Street	Boston, Mass.	448,131.10	923,381.10	
OTHER COMPANIES					
Alabama Great Southern Ry. Co.	60 Wall Tower	New York, N. Y.	22,500.00		
Aluminum Co. of America	230 Park Avenue	New York, N. Y.	12,000.00		
American Tel. & Tel. Co.	195 Broadway	New York, N. Y.	15,300.00		
Atchison, Topeka & Santa Fe Ry. Co.			3,000.00		
Brach, E. J., and Sons	4656 W. Kinzie St.	Chicago, Ill.	700.00		
Columbia Gas & Elec. Co.	61 Broadway	New York, N. Y.	9,000.00		
Commercial Molasses			105,000.00		
Commercial Solvents Corp.	230 Park Avenue	New York, N. Y.	8,525.00		
Consolidated Edison Co. of N. Y.	40 Irving Place	New York, N. Y.	1,000.00		
Cooperative G. L. F.		Buffalo, N. Y.	1.50		
Curtis Publishing Co.	Independence Square	Philadelphia, Pa.	4,125.00		
Electric Bond & Share Co.	2 Rector Street	New York, N. Y.	9,900.00		
Great Northern Railroad Co.			1,500.00		
Great Western Sugar Co.	Sugar Building	Denver, Colo.	6,230.00		
Hecker Products Corp.	88 Lexington Ave.	New York, N. Y.	1,800.00		
Lehigh Coal & Navigation Co.	1421 Chestnut St.	Philadelphia, Pa.	900.00		
National Biscuit Co.	449 West 14th St.	New York, N. Y.	6,600.00		
National City Bank of N. Y.	55 Wall St.	New York, N. Y.	3,000.00		
National Starch Products Co.	820 Greenwich St.	New York, N. Y.	359.33		
North American Co.	60 Broadway	New York, N. Y.	3,900.00		
Pennsylvania R. R. Co.	Broad St. Sta. Bldg.	Philadelphia, Pa.	8,250.00		
Prudential Investors, Inc.	15 Exchange Place	Jersey City, N. J.	1,584.00		
Public Service Corp. of N. J.	80 Park Place	Newark, N. J.	14,400.00		
South Porto Rico Sugar Co.	15 Exchange Place	Jersey City, N. J.	31,400.00		
Southern Calif. Edison Co., Ltd.	Edison Bldg.	Los Angeles, Calif.	5,500.00		
Union Pacific Railway Co.	120 Broadway	New York, N. Y.	21,000.00		
Virginian Railway Co., The	44 Wall Street	New York, N. Y.	5,400.00	302,874.83	1,226,255.93
FOREIGN CORPORATIONS					
Refinerias de Maiz, S. R. L.		Argentina	153,400.00		
Canada Starch Co.		Canada	201,523.22		
Corn Products Co., Ltd.		England	581,820.31		
Corn Products Company		Holland	82,511.01		
N. V. Stijfsel en Glucose Fabriek		Holland	282,263.75		
Corn Products Company		India	14,903.15		
Nippon Kokusan Kogyo K. K.		Japan	169,191.67		
Corn Products Company		Switzerland	2,724.18		
A. D. Za Preradu Kukuruza		Yugoslavia	4,731.46		
Deutsche Maizena Werke, A. G.		Germany	40,320.00		
Gesellschaft fur Industriebeteiligungen m.b.H.		"	40,320.00		
Transport und Lagerhaus Gesellschaft m.b.H.		"	5,616.00		
Finkenheerder Obstwerke, A. G.		"	1,036.80		
Mondamin Gesellschaft m.b.H.		"	3,456.00		
C. H. Knorr, A. G.		"	4,890.62		
Maizenahaus Gesellschaft m.b.H.		"	5,760.00		
Maizena Brasil, S. A.		Brazil	101,448.93		
Corn Products Company		Egypt	5,133.46		
				1,701,050.56	
TOTAL					2,927,306.49
REFINACOES DE MILHO					
Artefactos de Papelao, Ltd.		Brazil			1,277.05
Total as per Item 12, page one					2,928,583.54

Joint Exhibit 12-H.

376 CORN PRODUCTS REFINING COMPANY &
REFINACOES DE MILHO CONSOLIDATED RETURN

17 Battery Place New York, New York

CORPORATION INCOME, DECLARED VALUE
EXCESS-PROFITS AND DEFENSE TAX RETURN 1940

SCHEDULE H—TAXES

	Corn Products Refining Company		
	Federal		
377	Transfer taxes	8,174.62	
	Capital stock	159,189.50	
	Admission	500.00	
	Excise	76,377.91	
	Old Age Benefit	75,038.51	319,280.54
	State and Municipalities		
	Real state	237,428.15	
	Personal Property	115,915.27	
	Franchise	26,353.21	
	Income	19,734.76	
	License	10,219.68	
378	Excise	879.42	
	Sales	1,036.98	
	Miscellaneous	1.48	411,568.95
	Federal and State		
	Unemployment insurance tax		224,866.16
			955,715.65
	Refinacoes de Milho		
	Miscellaneous		24,897.95
	Total as per Item #21, page 1		980,613.60

HCH:RA

Joint Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED RETURN 379
17 Battery Place New York, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS PROFITS, AND DEFENSE TAX RETURN—1940

SCHEDULE I—CONTRIBUTIONS

CORN PRODUCTS REFINING COMPANY

Hias Emergency Fund	Brooklyn, N. Y.	$ 15.00
Community Federation of Boston	Boston, Mass.	100.00
Greater New York Fund	New York, N. Y.	2,500.00
Jewish Welfare Fund	Chicago, Ill.	200.00
United Charities	Philadelphia, Pa.	50.00 380
Norfolk Community Fund	Norfolk, Virginia	5.00
American Red Cross	Chicago, Illinois	750.00
American Polish Committee	New York, N. Y.	50.00
American Red Cross	New York, N. Y.	2,000.00
Indianapolis Community Fund	Indianapolis, Indiana	25.00
St. Mary's Hospital	Philadelphia, Pa.	10.00
Portland Community Fund	Portland, Oregon	10.00
Seattle Community Fund	Seattle, Washington	10.00
Spokane Community Fund	Spokane, Washington	5.00
Minneapolis Community Fund	Minneapolis, Minn.	15.00
St. Paul Community Chest	St. Paul, Minn.	10.00
Omaha Community Chest	Omaha, Nebraska	15.00
Salvation Army	Boston, Mass.	10.00 381
Allied Charities	Kansas City, Kansas	175.00
Allied Charities	Kansas City, Mo.	1,000.00
Federation of Jewish Charities	New York, N. Y.	150.00
Assoc. Jewish Philanthropies	Boston, Mass.	100.00
Community Chest	San Francisco, Calif.	50.00
Community Fund	Chicago, Illinois	2,000.00
United Charities Community Chest	St. Louis, Missouri	25.00
TOTAL—as per Item #22, Page 1		$9,280.00

Joint Exhibit 12-H.

382 CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED RETURN
17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN—1940

SCHEDULE J—DEPRECIATION

	Corn Products Refining Company		
	Plants		
383	Buildings	482,086.95	
	Machinery	925,655.56	
	Furniture and Fixtures	6,319.36	1,414,061.87
	Office furniture and fixtures		12,454.11
	Automobiles		14,903.65
			1,441,419.63
	Refinacoes de Milho		
	Buildings	18,853.28	
	Machinery	48,498.78	
384	Plant furniture and fixtures	391.35	
	Plant automobiles	1,491.51	
	Office furniture and fixtures	1,291.16	
	Office automobiles	386.09	70,912.17
	Total—as per Item #24, page one		1,512,331.80

Joint Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED RETURN
CORN PRODUCTS REFINING COMPANY
17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN 1940

SCHEDULE J .. DEPRECIATION
BUILDINGS — 2½%

ARGO

Year Acquired	Cost: New Purchases	Cost: Replacements	Cost: Total Cost	Depreciated To 12/31/39	Undepreciated To 12/31/39	Remaining Life In Years From 12/31/39	Depreciation 1940	Total
3-1-1910	2,659,611.59		2,659,611.59	2,113,021.19	546,590.40	10 1/6	53,763.03	
1910	749,000.97		749,000.97	588,077.47	160,923.50	10 7/12	15,205.38	
1	443,718.15		443,718.15	339,213.42	104,504.73	11½	9,087.36	
2	49,778.41		49,778.41	36,922.94	12,855.47	12½	1,028.43	
3	209,369.13		209,369.13	150,503.59	58,865.54	13½	4,360.41	
4	59,895.38		59,895.38	41,674.44	18,220.94	14½	1,256.61	
5	211,335.54		211,335.54	139,930.44	71,405.10	15½	4,606.78	
6	260,763.99		260,763.99	165,438.95	95,325.04	16½	5,777.27	
7	213,685.81		213,685.81	122,616.39	91,069.42	17½	5,203.96	
8	484,880.67	7,231.63	492,112.30	323,865.44	168,246.86	18½	9,994.42	
9	404,782.80	24,332.73	429,115.53	231,870.55	197,244.98	19½	10,115.13	
1920	1,063,784.09		1,063,784.09	539,363.83	524,420.26	20½	25,581.47	
1	250,606.59		250,606.59	120,879.11	129,727.48	21½	6,033.83	
2	93,971.70		93,971.70	43,006.09	50,965.61	22½	2,265.14	
3	609,246.44		609,246.44	262,726.48	346,519.96	23½	14,745.53	
4	162,971.14		162,971.14	65,682.00	97,289.14	24½	3,970.99	
5	34,520.15		34,520.15	12,935.67	21,584.48	25½	846.45	
6	290,146.70		290,146.70	100,487.45	189,659.25	26½	7,156.95	
7	51,681.28		51,681.28	16,427.22	35,254.06	27½	1,281.96	
8	36,741.02		36,741.02	10,629.31	26,111.71	28½	916.20	
9	24,616.58		24,616.58	6,461.81	18,154.77	29½	615.41	
1930	143,830.34		143,830.34	34,159.72	109,670.62	30½	3,595.76	
1	7,263.73		7,263.73	1,543.52	5,720.21	31½	181.59	
2	1,985.66		1,985.66	372.30	1,613.36	32½	49.64	
3	86,343.26		86,343.26	14,030.77	72,312.49	33½	2,158.58	
4	56,930.25		56,930.25	7,827.93	49,102.32	34½	1,423.26	
5	160,366.21		160,366.21	18,041.22	142,324.99	35½	4,009.16	
6	16,015.70		16,015.70	1,401.37	14,614.33	36½	400.39	
7	20,647.71		20,647.71	1,290.18	19,357.23	37½	516.19	
8	136,054.67		136,054.67	5,102.05	130,952.62	38½	3,401.37	
9	232,392.61	4,052.38	236,444.99	2,955.56	233,489.43	39½	5,911.12	
1940	87,877.17	9,616.29	97,493.46		97,493.46		1,218.67	
	9,314,815.44	45,233.03	9,360,048.47	5,518,458.71	3,841,589.76			205,778.44

EDGEMATER.

5-1-1902	967,050.69		967,050.69	932,262.37	34,788.32	2½	14,969.28	
3	62,918.74		62,918.74	59,358.11	3,560.63	3½	1,017.31	

7	51,681.28		51,681.28	16,427.22	35,254.06	27½	1,284.96	
8	36,741.02		36,741.02	10,629.31	26,111.71	28½	916.20	
9	24,616.58		24,616.58	6,461.81	18,154.77	29½	615.41	
1930	143,830.34		143,830.34	34,159.72	109,670.62	30½	3,595.76	
1	7,263.73		7,263.73	1,543.52	5,720.21	31½	184.59	
2	1,985.66		1,985.66	372.30	1,613.36	32½	49.64	
3	86,343.26		86,343.26	14,030.77	72,312.49	33½	2,158.58	
4	56,930.25		56,930.25	7,827.93	49,102.32	34½	1,423.26	
5	160,366.21		160,366.21	18,041.22	142,324.99	35½	4,009.16	
6	16,015.70		16,015.70	1,461.37	14,614.33	36½	400.39	
7	20,647.71		20,647.71	1,290.48	19,357.23	37½	516.19	
8	136,054.67		136,054.67	5,102.05	130,952.62	38½	3,401.37	
9	282,392.61	4,052.38	236,444.99	2,955.56	233,489.43	39½	5,911.12	
1940	87,877.17	9,616.29	97,493.46		97,493.46		1,218.67	
	9,314,815.44	45,233.03	9,360,048.47	5,518,458.71	3,841,589.76			205,778.44

EDGEWATER

5-1-1902	967,050.69		967,050.69	932,262.37	34,788.32	2⅛	14,909.28	
3	62,918.74		62,918.74	59,358.11	3,560.63	3½	1,017.31	
4	64,217.95		64,217.95	59,385.04	4,832.91	4½	1,073.99	
5	96,096.56		96,096.56	86,998.84	9,097.72	5½	1,654.13	
6	52,959.59		52,959.59	46,884.70	6,074.89	6½	934.59	
7	77,887.29		77,887.29	67,351.96	10,535.33	7½	1,404.72	
8	24,487.66		24,487.66	20,661.14	3,826.52	8½	450.18	
9	630.31		630.31	513.43	116.88	9½	12.31	
1910	8,589.36		8,589.36	6,806.07	1,783.29	10½	169.84	
1	16,165.33		16,165.33	12,447.27	3,718.06	11½	323.31	
3	2,081.33		2,081.33	1,508.15	573.18	13½	42.46	
4	25,032.91		25,032.91	17,531.43	7,501.48	14½	517.35	
5	27,598.61		27,598.61	18,645.30	8,953.31	15½	577.63	
7	19,920.56		19,920.56	11,361.39	8,559.17	17½	489.10	
8	73,634.38	37,935.18	111,569.56	75,249.50	36,320.06	18½	1,963.24	
9	53,705.18	80,001.15	133,706.33	71,876.42	61,829.91	19½	3,170.77	
1920	1,895,904.32		1,895,904.32	1,022,960.71	872,943.61	20½	42,582.61	
1	138,267.59		138,267.59	71,266.30	67,001.29	21½	3,116.34	
2	85,847.68		85,847.68	42,171.06	43,676.62	22½	1,941.18	
3	4,845.25		4,845.25	2,237.97	2,607.28	23½	110.95	
4	18,019.18		18,019.18	7,697.46	10,321.72	24½	421.29	
5	845.99		845.99	331.77	514.22	25½	20.16	
6	8,534.32		8,534.32	3,046.16	5,488.16	26½	207.10	
1930	3,022.16		3,022.16	717.73	2,304.43	30½	75.55	
1	1,908.58		1,908.58	405.54	1,503.04	31½	47.71	
2	1,002.88		1,002.88	188.03	814.85	32½	25.07	
3	113.31		113.31	18.40	94.91	33½	2.83	
4	13,519.82		13,519.82	1,859.00	11,660.82	34½	338.00	
5	40,660.38		40,660.38	4,574.29	36,086.09	35½	1,016.51	
6	53,664.75	9,935.29	63,600.04	5,565.00	58,035.04	36½	1,590.00	
7	7,112.24	6,383.09	13,195.33	843.45	12,651.88	37½	337.38	
8	6.61	160.29	166.90	6.26	160.64	38½	4.17	
9	3,024.33		3,024.33	37.80	2,986.53	39½	73.61	
1940	—	—	—	—	—		—	
	3,849,275.84	134,415.00	3,983,690.84	2,652,768.05	1,330,922.79			80,622.67

Joint Exhibit 12-II.

CORN PRODUCTS REFINING COMPANY & REFINACOES DE MILHO CONSOLIDATED RETURN
CORN PRODUCTS REFINING COMPANY
17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME DECLARED VALUE EXCESS PROFITS AND DEFENSE TAX RETURN 1940

SCHEDULE J DEPRECIATION
BUILDINGS — 2½%

PEKIN

Year Acquired	Cost: New Purchases	Cost: Replacements	Cost: Total Cost	Depreciated To 12/31/39	Undepreciated To 12/31/39	Remaining Life In Years From 12/31/39	Depreciation 1940	Total
Prior to 1906	457,405.00		457,405.00	499,424.08	42,019.08	—	—	
1906	43,590.00		43,590.00	42,773.43	816.57	6½	125.63	
7	3,950.00		3,950.00	3,831.41	118.59	7½	15.82	
8	58,340.00		58,340.00	55,853.46	2,486.54	8½	292.53	
1912	384,853.08		384,853.08	301,345.72	83,507.36	12½	6,680.59	
3	167,470.10		167,470.10	122,466.56	45,003.54	13½	3,333.60	
4	66,463.28		66,463.28	44,539.48	21,923.80	14½	1,511.98	
5	11,642.34		11,642.34	7,397.61	4,244.73	15½	273.86	
6	212.20		212.20	129.67	82.53	16½	5.00	
7	5,564.73		5,564.73	3,172.05	2,392.68	17½	136.73	
8	20,050.15	346.59	20,396.74	16,840.46	3,556.28	18½	192.23	
9	6,860.73	93.52	6,954.25	3,766.58	3,187.67	19½	163.47	
1920	1,879,841.19		1,879,841.19	953,124.26	926,716.93	20½	45,205.71	
1	277,004.06		277,004.06	133,611.88	143,392.18	21½	6,669.41	
2	1,299.55		1,299.55	594.70	704.85	22½	31.32	
3	444,408.01		444,408.01	191,642.88	252,765.13	23½	10,755.96	
4	90,164.43		90,164.43	36,338.82	53,825.61	24½	2,196.97	
5	118,903.59		118,903.59	44,556.28	74,347.31	25½	2,915.58	
6	16,425.30		16,425.30	5,688.67	10,736.63	26½	405.16	
7	91,297.62		91,297.62	29,019.59	62,278.03	27½	2,264.65	
8	1,019.84		1,019.84	293.03	724.81	28½	25.43	
9	702.43		702.43	184.38	518.05	29½	17.56	
1930	4,333.08		4,333.08	1,029.13	3,303.95	30½	108.33	
1	5,870.65		5,870.65	1,247.54	4,623.11	31½	146.77	
3	1,802.41		1,802.41	292.89	1,509.52	33½	45.06	
4	23,181.57		23,181.57	3,187.47	19,994.10	34½	579.54	
5	49,308.08	88,656.25	137,964.33	15,520.97	122,443.36	35½	3,449.10	
6	45,244.16		45,244.16	3,958.85	41,285.31	36½	1,131.10	
7	26,122.68		26,122.68	1,632.67	24,490.01	37½	653.07	
8	854,391.34	2,538.18	856,929.52	32,134.86	824,794.66	38½	21,423.24	
9	436,839.42	54.29	436,893.71	5,461.17	431,432.54	39½	10,922.34	
1940	108,621.38	5,217.73	113,839.11		113,839.11		1,422.99	
	5,703,182.40	96,906.56	5,800,088.96	2,561,062.55	3,239,026.41			123,100.73

Joint Exhibit 12-II.

CORN PRODUCTS REFINING COMPANY and REFINACOES DE MILHO CONSOLIDATED RETURN
CORN PRODUCTS REFINING COMPANY
17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN 1940

SCHEDULE J DEPRECIATION
MACHINERY — 6%

Year Acquired	Cost: New Purchases	Cost: Replacements	Cost: Total Cost	Depreciated to Dec. 31, 1939	Undepreciated to Dec. 31, 1939	Remaining Life in years from Dec. 31, 1939	Depreciation 1940	Total
ARGO								
Prior to 1923	9,929,401.51	236,374.88	10,165,776.39	10,165,776.39	—	—	—	
1923	1,432,830.30	97,147.55	1,529,977.85	1,519,557.31	10,420.54	1 1/6	10,420.54	
4	179,462.53	84,811.67	264,274.20	249,848.57	14,425.63	1 1/6	12,364.90	
5	277,525.05	62,406.45	339,931.50	303,058.38	36,873.12	2 1/6	17,018.43	
6	734,411.85	37,083.35	771,495.20	642,156.48	129,338.72	3 1/6	40,843.88	
7	353,567.62	65,397.54	418,965.16	321,130.02	97,835.14	4 1/6	23,480.18	
8	535,644.42	78,389.70	614,034.12	427,608.43	186,425.69	5 1/6	36,082.43	
9	334,075.81	170,117.16	504,192.97	317,641.66	186,551.31	6 1/6	30,251.59	
1930	835,677.83	66,126.48	901,804.31	514,028.61	387,775.70	7 1/6	54,108.28	
1	244,315.21	45,146.86	289,462.07	147,625.69	141,836.38	8 1/6	17,367.73	
2	290,969.69	26,198.71	317,168.40	142,725.82	174,442.58	9 1/6	19,030.11	
3	230,972.13	32,034.04	263,006.17	102,572.41	160,433.76	10 1/6	15,780.37	
4	240,351.98	49,309.59	289,661.57	95,588.30	194,073.27	11 1/6	17,379.69	
5	107,258.57	36,343.59	143,602.16	38,772.58	104,829.58	12 1/6	8,616.13	
6	249,387.90	46,915.61	296,303.51	62,223.74	234,079.77	13 1/6	17,778.21	
7	179,296.84	61,741.51	241,038.35	36,155.75	204,882.60	14 1/6	14,462.30	
8	495,827.45	122,556.04	618,383.49	55,654.51	562,728.98	15 1/6	37,103.01	
9	427,555.84	139,738.03	567,293.87	17,018.82	550,275.05	16 1/6	34,037.63	
1940	759,770.57	180,331.56	940,102.13		940,102.13		28,203.06	
	17,838,303.10	1,638,170.32	19,476,473.42	15,159,143.47	4,317,329.95			434,328.77
EDGEWATER								
Prior to 1923	2,984,504.97	462,823.45	3,447,328.42	3,897,680.04	449,951.62	—	—	
3	70,533.56	40,395.22	110,928.78	110,123.46	805.32	1/6	805.32	
4	8,240.87	22,122.29	30,363.16	28,634.58	1,728.58	1 1/6	1,481.68	
5	15,935.69	29,138.33	45,074.02	40,156.91	4,917.11	2 1/6	2,269.43	
6	67,413.59	15,455.15	82,868.74	68,976.04	13,892.70	3 1/6	4,387.17	
7	37,010.84	29,997.85	67,008.69	51,361.10	15,647.59	4 1/6	3,755.44	
8	102,267.62	16,193.08	118,460.70	82,495.07	35,965.63	5 1/6	6,961.09	
9	71,990.32	15,171.55	87,161.87	54,912.03	32,249.84	6 1/6	5,229.72	
1930	67,169.05	42,773.54	109,942.59	62,667.32	47,275.27	7 1/6	6,596.56	
1	3,848.54	11,566.83	7,718.29	3,936.35	3,781.94	8 1/6	463.10	
2	312,434.26	42,806.04	355,240.30	159,858.22	195,382.08	9 1/6	21,314.43	
3	43,434.91	4,508.94	47,943.85	18,698.10	29,245.75	10 1/6	2,876.63	
4	47,477.59	9,833.53	57,311.12	18,912.68	38,398.44	11 1/6	3,438.67	
5	5,030.13	2,440.59	7,470.72	2,017.08	5,453.64	12 1/6	448.24	
6	71,753.07	2,633.71	74,386.78	15,621.23	58,765.55	13 1/6	4,463.21	
7	116,032.87	14,474.45	130,507.32	19,576.10	110,931.22	14 1/6	7,830.44	
8	51,456.00	38,495.72	89,951.72	8,081.22	81,870.50	15 1/6	5,397.10	
9	28,869.75	40,206.66	69,076.41	2,072.29	67,004.12	16 1/6	4,144.58	
1940	72,638.68	776.03	71,862.65		71,862.65		2,155.88	
	4,025,467.87	841,812.96	4,867,280.83	4,645,779.82	221,501.01			79,706.93

Joint Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY and REFINACOES DE MILHO CONSOLIDATED RETURN

CORN PRODUCTS REFINING COMPANY
17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN 1940

SCHEDULE J DEPRECIATION
MACHINERY — 6%

Year Acquired	Cost: New Purchases	Cost: Replacements	Cost: Total Cost	Depreciated to Dec. 31, 1939	Undepreciated to Dec. 31, 1939	Remaining Life in years from Dec. 31, 1939	Depreciation 1940	Total
N. KANSAS CITY								
Prior to 1923	2,968,874.95		2,968,874.95	2,968,874.95	—	—		
3	26,665.78	5,341.54	32,007.32	31,765.81	241.51	1 1/6	241.51	
4	4,268.51	15.40	4,283.91	4,034.14	249.77	1 1/6	200.85	
5	10,804.09		10,804.09	9,608.48	1,195.61	2 1/6	551.83	
6	105,934.71	9,463.67	115,398.38	95,429.91	19,968.47	3 1/6	6,305.86	
7	56,657.10	9,538.25	66,195.35	50,366.43	15,828.92	4 1/6	3,798.95	
8	800,791.42	4,999.97	805,791.39	559,835.11	245,956.28	5 1/6	47,604.50	
9	29,929.02	8,341.58	38,270.60	24,110.52	14,160.08	6 1/6	2,296.24	
1930	126,768.07	9,791.88	136,559.95	77,839.20	58,720.75	7 1/6	8,193.60	
1	144,925.94	16,760.60	161,686.54	82,460.12	79,226.42	8 1/6	9,701.19	
2	31,274.44	9,557.00	40,831.44	18,374.17	22,457.27	9 1/6	2,449.89	
3	81,630.27	2,157.96	83,788.23	32,677.39	51,110.84	10 1/6	5,027.29	
4	42,587.12	2,732.94	45,320.06	14,955.60	30,364.46	11 1/6	2,719.20	
5	91,952.88	7,392.35	99,345.23	26,823.20	72,522.03	12 1/6	5,966.71	
6	59,097.09	62,678.10	121,775.19	25,572.79	96,202.40	13 1/6	7,306.51	
7	84,292.11	20,917.96	105,210.07	15,781.50	89,428.57	14 1/6	6,312.60	
8	46,110.35	5,583.35	51,693.70	4,652.43	47,041.27	15 1/6	3,101.62	
9	96,294.63	60,150.10	156,444.73	4,693.34	151,751.39	16 1/6	9,386.68	
1940	321,778.35	101,239.99	423,018.34		423,018.34		12,690.55	
	5,100,491.63	336,631.84	5,437,123.47	4,020,569.85	1,416,553.62			132,344.22
PEKIN								
Prior to 1923	3,915,010.50	175,195.45	4,090,205.95	4,466,038.56	375,832.61		—	
3	626,372.24	20,151.64	646,523.88	642,151.68	4,372.20	1/6	4,372.20	
4	310,881.10	14,330.37	325,211.47	307,977.55	17,233.92	1 1/6	14,772.01	
5	13,236.30	29,684.18	16,447.88	14,590.92	1,856.96	2 1/6	857.08	
6	115,253.98	38,949.13	154,203.11	128,351.47	25,851.64	3 1/6	8,163.70	
7	88,763.13	26,566.75	115,329.88	88,397.43	26,932.45	4 1/6	6,463.79	
8	51,055.15	17,433.36	68,488.51	47,694.83	20,793.68	5 1/6	4,024.58	
9	95,238.31	26,629.54	121,867.85	76,776.74	45,091.11	6 1/6	7,312.07	
1930	21,756.67	14,165.78	35,922.45	20,475.82	15,446.63	7 1/6	2,155.35	
1	25,329.15	20,252.69	45,581.84	23,246.74	22,335.10	8 1/6	2,734.91	
2	8,077.73	16,071.54	24,149.27	10,867.20	13,282.07	9 1/6	1,448.96	
3	51,602.18	9,820.87	61,423.05	23,954.97	37,468.08	10 1/6	3,685.38	
4	306,581.04	13,350.29	319,931.33	105,577.34	214,353.99	11 1/6	19,195.88	
5	92,665.11	28,479.58	121,144.69	32,709.06	88,435.63	12 1/6	7,268.68	
6	66,641.38	36,208.33	102,849.71	21,598.14	81,251.28	13 1/6	6,170.98	
7	67,437.39	75,223.59	142,660.98	21,399.15	121,261.83	14 1/6	8,559.66	
8	1,760,778.04	72,068.46	1,832,846.50	164,956.19	1,667,890.31	15 1/6	109,970.79	
9	943,792.59	78,278.25	1,022,070.84	30,662.13	991,408.71	16 1/6	61,324.25	
1940	302,929.07	56,916.75	359,845.82		359,845.82		10,795.37	
	8,836,928.46	769,776.55	9,606,705.01	6,227,426.21	3,379,278.80			279,275.64
								925,655.56

Joint Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY AND
REFINACOES DE MILHO CONSOLIDATED RETURN

CORN PRODUCTS REFINING COMPANY
17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN—1940

SCHEDULE J DEPRECIATION
OFFICE FURNITURE AND FIXTURES 6⅔%

Year Acquired	Cost	Depreciation to 12/31/39	Undepreciated to 12/31/39	Remaining Life In Years	Depreciation 1940
Prior to 1925	32,220.92	32,220.92	—	—	
1925	6,701.01	6,563.02	137.99	½	137.99
6	6,344.64	5,893.80	450.84	1½	300.53
7	11,233.08	9,762.08	1,471.00	2½	588.40
8	29,139.40	23,374.87	5,764.53	3½	1,647.01
9	14,408.81	10,518.44	3,890.37	4½	864.53
1930	6,947.14	4,541.36	2,405.78	5½	437.41
1	4,883.45	2,803.77	2,079.68	6½	319.95
2	10,247.42	5,123.70	5,123.72	7½	683.16
3	11,213.73	4,859.27	6,354.46	8½	747.58
4	6,860.54	2,515.53	4,345.01	9½	457.37
5	10,369.60	3,110.89	7,258.71	10½	691.31
6	16,287.95	3,800.51	12,487.44	11½	1,085.86
7	20,384.11	3,397.35	16,986.76	12½	1,358.94
8	19,706.31	1,970.64	17,735.67	13½	1,313.76
9	20,076.44	669.22	19,407.22	14½	1,338.43
1940	14,456.39		14,456.39		481.88
	241,480.94	121,125.37	120,355.57		
Total Depreciation Office Furniture and Fixtures					12,454.11
AUTOMOBILES					
1926	3,017.50	2,917.50	100.00	—	
1931	10,096.76	9,393.25	703.51	303.51	
1932	5,048.22	4,848.22	200.00	—	
1933	37,113.03	35,713.03	1,400.00	—	
1934	8,250.77	7,850.77	400.00	—	
1935	10,105.68	8,986.68	1,119.00	619.00	
1936	9,556.24	6,127.24	3,429.00	1,740.00	
1937	19,786.86	9,225.87	10,560.99	3,480.00	
1938	25,220.77	8,903.60	16,317.17	5,142.40	
1939	4,543.85	704.00	3,839.85	1,392.00	
1940	12,647.76	—	12,647.76	1,932.00	
Cars traded 1940	14,173.34	12,467.60	1,705.74	294.74	
	159,560.78	107,137.76	52,423.02		14,903.65
PATENTS					
Oct. 14, 1935	2,500.00	1,465.23	1,034.77	344.76	
July 2, 1935	3,900.00	2,420.64	1,479.36	537.92	
	6,400.00	3,885.87	2,514.13		882.68
					28,240.44

Joint Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY & REFINACOES DE MILHO
CONSOLIDATED RETURN
CORN PRODUCTS REFINING COMPANY
17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME DECLARED VALUE EXCESS PROFITS AND DEFENSE TAX RETURN 1940

SCHEDULE J DEPRECIATION
FURNITURE & FIXTURES—6⅔%

Year Acquired	Cost	Depreciated To 12/31/39	Undepreciated To 12/31/39	Remaining Life In Years	Depreciation 1940	Total
ARGO						
Prior to 1925	4,817.83	4,817.83	—	—		
1925	1,026.11	1,004.96	21.15	½	21.15	
6	2,531.40	2,351.54	179.86	1½	119.91	
7	1009.79	877.52	132.27	2½	52.89	
8	1,862.55	1,494.06	368.49	3½	105.27	
9	2,963.45	2,163.35	800.10	4½	177.81	
1930	907.44	593.23	314.21	5½	57.14	
1	2,103.37	1,207.65	895.72	6½	137.81	
2	1,044.10	522.07	522.03	7½	69.61	
3	2,074.19	898.82	1,175.37	8½	138.28	
4	4,411.97	1,617.72	2,794.25	9½	294.13	
5	2,286.29	685.89	1,600.40	10½	152.42	
6	927.09	216.33	710.76	11½	61.81	
7	4,934.77	822.45	4,112.32	12½	328.98	
8	6,516.80	651.68	5,865.12	13½	434.45	
9	8,367.61	278.92	8,088.69	14½	557.84	
1940	5,141.40		5,141.40		171.38	
	52,926.16	20,204.02	32,722.14			2,880.88
EDGEWATER						
Prior to 1925	3,753.26	3,753.26	—	—		
1925	16.88	16.51	.37	½	.37	
6	229.77	213.43	16.34	1½	10.88	
7	581.55	505.37	76.18	2½	30.46	
8	947.49	760.02	187.47	3½	53.55	
9	2,890.08	2,109.72	780.36	4½	173.40	
1930	406.73	265.89	140.84	5½	25.61	
1	117.00	67.21	49.79	6½	7.67	
2	530.90	265.43	265.47	7½	35.39	
3	1,651.12	715.46	935.66	8½	110.07	
4	595.05	218.18	376.87	9½	39.67	
5	841.50	252.45	589.05	10½	56.10	
6	1,284.34	299.67	984.67	11½	85.62	
7	1,730.27	288.38	1,441.89	12½	115.35	
8	6,133.67	613.37	5,520.30	13½	408.91	
9	3,184.08	106.14	3,077.94	14½	212.27	
1940	1,494.50		1,494.50		49.82	
	26,388.19	10,450.49	15,937.70			1,415.14

Joint Exhibit 12-II.

No. Kansas City

Prior to 1926	278.00	278.00	- -	—		
1926	607.00	563.85	43.15	1½	28.75	
7	667.20	579.84	87.36	2½	34.95	
8	591.14	474.17	116.97	3½	33.41	
9	761.69	556.02	205.67	4½	45.70	
1930	532.98	348.43	184.55	5½	33.56	
1	182.83	104.98	77.85	6½	11.98	
2	190.96	95.48	95.48	7½	12.73	
3	651.80	282.43	369.37	8½	43.45	
4	1,480.03	542.68	937.35	9½	98.67	
5	332.24	99.67	232.57	10½	22.15	
6	655.73	153.02	502.71	11½	43.72	
7	3,695.10	615.85	3,079.25	12½	246.34	
8	2,164.12	216.41	1,947.71	13½	144.27	
9	1,302.56	43.42	1,259.14	14½	86.84	
1940	495.89		495.89		16.53	
	14,589.27	4,954.25	9,635.02			903.05

Pekin

Prior to 1925	1,803.03	1,803.03	—			
5	824.50	807.53	16.97	½	16.97	
6	794.33	737.85	56.48	1½	37.62	
7	760.93	661.29	99.64	2½	39.86	
8	647.41	519.32	128.09	3½	36.59	
9	71.13	51.94	19.19	4½	4.27	
1930	255.66	167.15	88.51	5½	16.10	
1	459.77	263.95	195.82	6½	30.12	
2	10.80	5.40	5.40	7½	.72	
3	1,317.86	571.09	746.77	8½	87.86	
4	75.01	27.50	47.51	9½	5.00	
5	445.90	133.78	312.12	10½	29.73	
6	2,972.69	693.63	2,279.06	11½	198.18	
7	2,872.07	478.68	2,393.39	12½	191.47	
8	4,248.29	424.83	3,823.46	13½	283.22	
9	665.70	22.19	643.51	14½	44.38	
1940	2,945.92		2,945.92		98.20	
	21,171.00	7,369.16	13,801.84			1,120.29
						6,319.36

NORTH KANSAS CITY

1922	2,181,672.72		2,181,672.72	1,025,386.18	1,156,286.54	22	52,558.48	
3	8,608.40		8,608.40	3,712.28	4,896.12	23½	208.35	
4	63,390.27		63,390.27	25,548.03	37,842.24	24½	1,544.58	
6	1,690.74		1,690.74	585.58	1,105.16	26½	41.71	
8	282,101.70		282,101.70	81,613.12	200,488.58	28½	7,034.69	
9	41.63		41.63	10.92	30.71	29½	1.04	
1930	15,245.79		15,245.79	3,620.90	11,624.89	30½	381.15	
1	21,066.81		21,066.81	4,476.70	16,590.11	31½	526.67	
2	635.66		635.66	119.18	516.48	32½	15.89	
4	22,991.27		22,991.27	3,161.29	19,829.98	34½	574.78	
5	26,217.25		26,217.25	2,949.44	23,267.81	35½	655.43	
6	143,865.67		143,865.67	12,588.24	131,277.43	36½	3,596.64	
7	175,149.17	9,178.75	184,327.92	11,520.50	172,807.42	37½	4,608.20	
8	12,811.54	4.53	12,816.07	480.60	12,335.47	38½	320.40	
9	2,434.19		2,434.19	30.43	2,403.76	39½	60.85	
1940	37,809.77	1,232.64	39,042.41		39,042.41		488.03	
	2,994,461.26	10,415.92	3,004,877.18	1,175,565.03	1,829,312.15			72,585.11
								482,086.95

Joint Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY and REFINACOES DE MILHO CONSOLIDATED RETURN
REFINACOES DE MILHO
CAIXA POSTAL 2972, SAO PAULO, BRAZIL, S. A.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN 1940

SCHEDULE J DEPRECIATION

Acquired	Rs.	Book Cost Rate	$	Adjustment	Depreciable Cost	Depreciation to Dec. 31, 1939	Undepreciated to Dec. 31, 1939	Depreciation 1940	Total
				Buildings 2½%					
Aug. 1, 1930	2,518,693$700	.094555	238,155.08	456,124.12	694,279.20	163,444.90	530,834.30	17,356.98	
1930	9,009$549	.094555	851.90		851.90	196.14	655.76	21.30	
1	12,034$300	.061807	743.80		743.80	158.02	585.78	18.59	
2	230,000$000	.076400	17,572.00		17,572.00	3,294.75	14,277.25	439.30	
6	104,018$170	.059562	6,195.53		6,195.53	542.11	5,653.42	154.89	
7	7,258$757	.059562	432.35		432.35	32.43	399.92	10.81	
7	2,579$832	.052227	134.74		134.74	8.40	126.34	3.36	
8	513,776$936	.058600	30,107.33		30,107.33	1,129.02	28,978.31	752.68	
9	$030	.060580			—	—	—	—	
1940	154,500$000	.060575	9,358.84		9,358.84		9,358.84	116.99	
	3,537,353$700		302,686.87	456,124.12	758,810.99	168,740.91	590,070.08		18,853.28
				Machinery 6%					
Aug. 1, 1930	3,462,180$400	.094555	327,366.47	352,897.34	680,263.81	384,349.07	295,914.74	40,815.83	
1930	22,934$758	.094555	2,168.59		2,168.59	1,198.19	970.40	130.12	
1	49,329$316	.061807	3,048.90		3,048.90	1,554.91	1,493.99	182.93	
2	157,244$732	.076400	12,013.50		12,013.50	5,406.08	6,607.42	720.81	
4	18,000$000	.081825	1,472.85		1,472.85	486.03	986.82	88.37	
5	108,000$000	.055000	5,994.00		5,994.00	1,618.38	4,375.62	359.64	
5	6,284$569	.055000	348.79		348.79	94.18	254.61	20.93	
6	227,589$108	.059562	13,555.66		13,555.66	2,846.69	10,708.97	813.34	
6	40,390$654	.059562	2,405.75		2,405.75	505.22	1,900.53	144.35	
7	7,258$757	.059562	432.35		432.35	77.82	354.53	25.94	
7	102,103$497	.052277	5,337.66		5,337.66	800.65	4,537.01	320.26	
8	782,819$354	.058600	45,873.21		45,873.21	4,128.60	41,744.61	2,752.40	
9	64,705$378	.060580	3,919.85		3,919.85	117.60	3,802.25	235.19	
1940	1,039,300$400	.060575	62,955.62		62,955.62		62,955.62	1,888.67	
	6,088,140$923		486,893.20	352,897.34	839,790.54	403,183.42	436,607.12		48,498.78
				Plant Furniture and Fixtures 10%					
Aug. 1, 1930	25,479$700	.094555	2,409.23	892.76	1,516.47	1,428.04	88.43	88.43	
1930	12,195$450	.094555	1,153.14		1,153.14	1,061.81	91.33	91.33	
1	5,830$000	.061807	360.33		360.33	306.26	54.07	36.03	
2	235$000	.076400	17.95		17.95	13.50	4.45	1.80	
3	630$000	.086062	54.22		54.22	35.23	18.99	5.42	
4	1,923$700	.081825	157.41		157.41	86.57	70.84	15.74	
6	10,186$700	.059562	606.74		606.74	212.34	394.40	60.67	
8	2,370$000	.058600	138.88		138.88	20.82	118.06	13.89	
9	8,181$050	.060580	495.61		495.61	24.78	470.83	49.56	
1940	9,401$900	.060575	569.52		569.52		569.52	28.48	
	76,433$500		5,963.03	892.76	5,070.27	3,189.35	1,880.92		391.35

Joint Exhibit 12-II.

REFINACOES DE MILHO

CAIXA POSTAL #2972, SAO PAULO, BRAZIL, S. A.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN 1940

SCHEDULE J DEPRECIATION

Acquired	Rs.	Book Cost Rate	$	Adjustment	Depreciable Cost	Depreciation to Dec. 31, 1939	Undepreciated to Dec. 31, 1939	Depreciation 1940	Total
					Plant Automobiles 25%				
Aug. 1, 1930	5,889$300	.094555	556.86	143.66	700.52	700.52	—		
1	19,553$143	.061807	1,208.52		1,208.52	1,208.52	—		
2	16,720$700	.076400	1,275.93		1,275.93	1,275.93	—		
3	3,196$000	.086062	275.05		275.05	275.05	—		
4	21,719$300	.081825	1,777.18		1,777.18	1,777.18	—		
5	12,165$000	.055500	675.16		675.16	675.16	—		
6	32,396$857	.059562	1,929.62		1,929.62	1,688.40	241.22	241.22	
7	10,937$500	.052277	571.88		571.88	357.43	214.45	142.97	
8	15,415$800	.058600	903.37		903.37	338.77	564.60	225.84	
9	58,202$400	.060580	3,525.90		3,525.90	440.74	3,085.16	881.48	
1940	—		—		—	—	—	—	
	189,804$000		12,149.37	143.66	12,293.03	8,187.60	4,105.43		1,491.51
					Office Furniture and Fixtures 10%				
1930	53,132$900	.094555	5,023.98		5,023.98	4,626.27	397.71	397.71	
1	27,512$700	.061809	1,700.48		1,700.48	1,445.42	255.06	170.05	
2	6,810$342	.076400	520.31		520.31	390.23	130.08	52.03	
3	13,528$479	.086062	1,164.29		1,164.29	756.79	407.50	116.43	
4	8,531$800	.081825	698.11		698.11	383.96	314.15	69.81	
5	12,691$500	.055500	704.38		704.38	316.98	387.40	70.44	
6	5,552$600	.059562	330.72		330.72	99.22	231.50	33.07	
7	16,922$463	.052277	884.66		884.66	221.17	663.49	88.47	
8	42,474$200	.058600	2,488.99		2,488.99	373.35	2,115.64	248.90	
9	9,426$300	.060580	571.05		571.05	28.55	542.50	57.11	
1940	30,112$700	.060575	1,824.08		1,824.08		1,824.08	91.20	
	213,075$300		14,870.43		14,870.43	7,861.48	7,008.95		1,291.16
					Office Automobiles 25%				
1940	50,990$000	.060575	3,088.72		3,088.72		3,088.72	386.09	
									386.09
									70,912.17

Joint Exhibit 12-H.

412 CORN PRODUCTS REFINING COMPANY AND REFINAÇOES DE MILHO CONSOLIDATED RETURN
17 Battery Place New York, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN 1940

SCHEDULE K — OTHER DEDUCTIONS

CORN PRODUCTS REFINING COMPANY

	ADMINISTRATIVE AND GENERAL EXPENSES		
	Patents and trademarks	67,074.39	
	Unclaimed wages	2.80	
	Pension insurance	371,466.80	
413	Exchange and collection	248.32	
	Foreign general expense	151,051.06	
	General expense	245,256.08	
	Group insurance	106,700.01	
	Insurance	134,511.40	
	Legal expense	72,573.70	
	Edgewater liquidation account	222,117.60	
	Demurrage	1,071.40	
	Office expense—sundry branches	204,793.72	1,576,867.28
	SELLING EXPENSES		
	General selling expense	4,569.43	
	Storage and handling	68,822.71	
	Commission and brokerage	49,294.60	
414	Advertising budget	21,515.79	144,202.53
	TOTAL		1,721,069.81

REFINAÇOES DE MILHO

	SELLING EXPENSES		
	Commission and brokerage	234,264.15	
	General selling expense	1,302.07	
	Advertising	42,579.17	
	Service and development	2,244.55	
	Samples	660.33	281,050.27

Joint Exhibit 12-H.

ADMINISTRATIVE AND GENERAL EXPENSES			415
Insurance	6,530.14		
Office expense	12,868.07		
Traveling expense	13,008.45		
General expense	7,459.08		
Exchange and collection	2,910.02		
Bank charges	726.42		
Foreign exchange	6,849.39		
Trademarks	1,978.99		
Legal and auditing expense	710.96		
Pension Fund	661.53	53,703.05	
TOTAL		334,753.32	
TOTAL—as per line 28, page one		2,055,823.13	416

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Joint Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY and REFINACOES DE MILHO CONSOLIDATED RETURN 1940

CORN PRODUCTS REFINING COMPANY
17 Battery Place New York, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS, AND DEFENSE TAX RETURN 1940

SCHEDULE — BALANCE SHEETS

Assets	December 31, 1939		December 31, 1940	
Property and Plant				
Real estate, plants, machinery, etc.	71,218,171.89		62,944,216.20	
Less: Depreciation Reserve	35,314,860.92	35,903,310.97	29,168,198.90	33,776,017.30
Investments				
Stocks and notes of subsidiary and affiliated companies at cost or less	31,047,160.74		30,743,677.57	
Other investments, including mortgages, at cost or less	1,619,852.25	32,667,012.99	1,146,245.69	31,889,923.26
Current Assets				
Cash in bonds and on hand	15,281,844.17		17,078,133.07	
Marketable securities	5,577,262.13		5,263,848.83	
Interest accrued on securities	14,082.52		16,154.86	
Notes receivable and accounts receivable	344,011.18		123,011.88	
Due from subsidiary and controlled companies	14,301,403.94		13,760,429.29	
Inventories, at the lower of cost or market, finished products, materials and supplies	7,527,720.34	43,046,324.28	7,593,823.61	43,835,401.54
Deferred Assets and Charges				
Prepaid insurance, other expenses, and unadjusted accounts	966,668.45		945,593.65	
Notes and accounts receivable, not current	1,275,716.52			
Foreign deposits, securities, and amounts due from foreign subsidiary and affiliated companies, subject to exchange restrictions	1,334,646.84	3,577,031.81	1,239,175.84	2,184,769.49
Treasury Stock				
4,262 Shares preferred at cost		469,856.25		469,856.25
		115,663,536.30		112,155,967.84
Liabilities, Capital Stock and Surplus				
Capital Stock				
Preferred stock— 250,000 shares @ $100.00	25,000,000.00		25,000,000.00	
Common stock —2,530,000 shares @ $25.00	63,250,000.00	88,250,000.00	63,250,000.00	88,250,000.00
Current Liabilities				
Accounts payable	1,810,641.22		1,216,309.59	
Dividend on preferred and common stock, payable in January	2,327,541.50		2,327,541.50	
Due to subsidiary and affiliated companies	541,819.58		531,312.69	
Federal income and other corporate taxes	3,231,814.59	7,911,816.89	3,386,849.51	7,462,018.29
Deferred Credits to Income		1,671,383.40		
Reserves				
For possible loss on miscellaneous investments	100,000.00		0	
For contingencies	—		200,000.00	
For merchandise inventories	316,759.42		924,164.69	
For depreciation of marketable securities	838,521.75	1,255,281.17	478,566.36	1,602,731.05
Surplus—Earned		16,575,054.84		14,841,223.50
		115,663,536.30		112,155,967.84

Joint Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED RETURN

REFINACOES DE MILHO

17 BATTERY PLACE . NEW YORK, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS PROFITS, AND DEFENSE TAX RETURN 1940

SCHEDULE — BALANCE SHEETS

ASSETS	DECEMBER 31, 1939		DECEMBER 31, 1940	
FIXED ASSETS				
Real Estate, Plant and Equipment	584,542.04		712,120.54	
Less: Depreciation Reserve	363,612.91	220,929.40	376,238.04	335,882.50
Office Furniture and Fixtures	12,465.10		15,995.76	
Less: Depreciation Reserve	7,745.76	4,719.34	8,496.29	7,499.47
Total Fixed Assets less Depreciation Reserve		225,648.44		343,381.97
Trademark, Patents and Goodwill		9,813.96		8,117.05
Deposits in Guarantee				1,621.41
Current Assets				
Cash in Banks and on Hand	85,320.81		31,621.56	
Accounts and Notes Receivable less Reserve for Bad Debts	190,956.81		122,612.32	
Investments	4,629.22			
Inventories	367,033.90		537,498.30	
Merchandise in Transit			1,698.43	
Bill Stamps	550.23		1,142.34	
Other Current Assets	17,435.35		13,677.37	
Total Current Assets		665,926.32		708,250.32
Deferred Charges		12,147.48		9,649.17
TOTAL ASSETS		913,536.20		1,071,019.92
Deficit		34,701.22		12,706.74
		948,237.42		1,083,726.66
LIABILITIES				
Capital				
Head Office Capital Account		50,929.61		50,925.40
Plant and Working Fund Account		345,897.71		345,769.18
Current Liabilities				
Affiliated Companies	500,353.71		618,326.33	
Suspense	620.30			
Other Current Liabilities	41,353.49		57,386.25	
Total Current Liabilities		542,327.50		675,712.58
Reserves				
Reserve for Taxes	3,124.60		2,233.25	
Reserve for Employees Compensation on Dismissal	6,058.00		9,086.25	
Total Reserves		9,182.60		11,319.50
TOTAL LIABILITIES		948,237.42		1,083,726.66

Joint Exhibit 12-H.

124 CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED RETURN

17 Battery Place New York, N. Y.

CORPORATION INCOME DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN FOR THE CALENDAR YEAR 1940

SCHEDULE M—RECONCILIATION OF NET INCOME AND ANALYSIS OF EARNED SURPLUS AND UNDIVIDED PROFITS

	Corn Products Refining Co.	Refinacoes De Milho
1. Total distribution to stockholders charged to earned surplus during the year	9,310,166.00	
3. Federal Income Taxes	2,441,213.34	
7. Additions to surplus reserves		
125 (a) Inventory adjustment	741,110.84	
(b) Reserve for contingencies	100,000.00	
8. Other unallowable deductions		
(a) Building charge-off	4,000.00	
(b) Developments and experiments	47,647.17	
(d) Research and development—Santo Domingo	49,355.39	
(e) Reserve for dismissal of employees		3,028.75
(f) Organization expense		3,785.94
(g) Reserve Brazilian income tax		1,444.95
9. Adjustments not recorded on books		
(a) German interest in Blocked Income from Affiliated Companies	6,320.28	
(b) Foreign dividends in Blocked Income from Affiliated Companies	101,399.42	
(c) Foreign dividends in Deferred Income	106,582.39	
(d) Foreign dividends in 1941 Income from Affiliated Companies	150,750.00	
126 (e) Royalties in Deferred Income	343,715.55	
(f) Royalties in 1941 Income from Affiliated Companies	223.31	
(g) Allowance adjustment for 1940, recorded 1941	2,631.83	
(h) Interest credited to investment account	358.00	
(i) Portion of foreign exchange considered short term capital loss	562,683.20	
(j) Foreign exchange loss on sale of Lira not used on return	314,241.72	
(k) Long term capital gain on sale and release of Lira and Marks	918,344.05	
10. Sundry debit to Earned Surplus re Edgewater Plant	2,000,268.57	
11. Earned surplus and undivided profits at close of the taxable year	14,841,223.50	12,706.74
	31,741,787.94	4,447.10

Joint Exhibit 12-H.

	Corn Products Refining Co.	Refinacoes De Milho
13. Earned surplus and undivided profits at close of the preceding taxable year	16,575,054.84	34,698.35
14. Adjusted net income	8,768,903.79	26,176.86
15. Nontaxable and partially exempt income:		
(a) Interest on		
(1) Obligations of a State, Territory or political subdivision thereof, or the district of Columbia, or United States possessions	624.56	
(2) Obligations of the United States issued on or before Sept. 1, 1917, Treasury notes, Treasury bills, and Treasury Certificates of Indebtedness	947.90	
(3) United States savings bonds and Treasury bonds owned in the principal amount of $5,000 or less	77.34	
(4) United States Savings Bonds and Treasury Bonds owned in the principal amount of over $5,000	2,629.69	
(5) Obligations of instrumentalities of the United States	45.21	
(b) Other Non-taxable income:		
(1) Adjustment of building charge-off	3.55	
16. Charges against surplus reserves		
(a) Additional compensation	293,497.00	
(b) Reserve decrease for elimination of inter-company profit	82,294.03	
17. Adjustments not recorded on the books		
(a) Income from Affiliated Company items accrued in prior years	2,160,743.91	
(b) Foreign dividend accrued in prior year—Interest & Dividend Account	111,986.58	
(c) Capital loss	3,227,842.68	
(d) Patent amortization	882.68	
(e) Inventory adjustment credited to Profit and Loss	162,671.10	
(f) Credit to Merchandise Account in 1940 reversing 1939 debit not used on 1939 return	156,956.07	
(g) German foreign purchase and sale item accrued 1939	12,634.41	
(h) Foreign exchange loss not recorded on the books	167,310.00	
(i) Allowance adjustment accrued in 1939	2,803.80	
(j) Reversal of 1939 foreign exchange adjustment—not used in 1939	1,859.99	
(k) Foreign general expense adjustment accrued in 1939	12,018.81	
(l) Additional allowable depreciation		56,417.93
(m) Reduction in current asset value		10.18
	31,741,787.94	4,447.10

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Exhibit 12-H.

430 CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED RETURN

17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN—1940

SCHEDULE O—OTHER INCOME

Corn Products Refining Company

Miscellaneous allowances	32,767.53	
Commissions on Corn purchased	1,634.67	
Foreign purchase and sale	44,200.72	
Operation W. 5th Ave. Property	611.52	79,214.44

431 *Refinacoes de Milho*

Sale of corn bags	8,336.36	
Sundry income	14.42	
Reduction in value of net current assets	10.18	8,340.60
Total—as per Item #13—page 1		87,555.04

STATEMENT IN SUPPORT OF CREDIT CLAIMED ON CORPORATION INCOME TAX RETURN FOR TAXES PAID OR ACCRUED TO A FOREIGN COUNTRY OR A POSSESSION OF THE UNITED STATES

432 To Be Filed by a Domestic Corporation

For Calendar Year 1940

Name of Corporation Corn Products Refining Company

Address 17 Battery Place, New York, New York

Claim for credit is made by the domestic corporation named above, on the attached corporation income tax return, which is based on income accrued for the taxable year begun January 1, 1940, and ended December 31, 1940, for taxes accrued, as follows:

I. Normal-tax net income from all sources (computed without any deductions for any income, war-profits, and excess-profits taxes paid to foreign countries)		$7,726,586.25
Total United States income tax on Item I		1,854,380.70

Exhibit 12-H.

SCHEDULE A—Taxes Paid or Accrued During the Taxable Year to a Possession of the United States or a foreign Country 433

Schedule Attached

SUMMARY OF INCOME RECEIVED AND TAXES PAID, AS SHOWN IN SCHEDULE (OR SCHEDULES) A

Schedule A, Item 3 Schedule Attached

Schedule A, Item 9 Schedule Attached

I.	Total net income from sources without United States (computed without deductions for any income and profits taxes imposed by any foreign country or possession of United States) (total of Column A)	$1,254,188.37	434
II.	Total taxes paid or accrued to foreign countries or possessions of United States as separately limited (total of Column B)	$ 252,218.66	
III.	Normal-tax net income from all sources (computed without deductions for any income and profits taxes paid or accrued to foreign countries or possessions of United States) (same as Item I, page 1)	$7,726,586.25	
IV.	Ratio of income from sources without United States to normal-tax net income from all sources (Item I divided by Item III)	16.232115%	
V.	Total United States income tax on Item III (same as Item II, page 1)	$1,854,380.70	435
VI.	Amount of tax which may be claimed as a credit on attached corporation income tax return (Item V multiplied by Item IV, or Item II, whichever amount is the smaller)	$ 252,218.66	

Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED RETURN
17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN 1940

CORN PRODUCTS REFINING COMPANY
COMPUTATION OF FOREIGN TAX CREDIT UNDER SECTION 131 (a) and 131 (f)

	Dividend Foreign Currency	Dividend	% of Gross Income Positive Items (1) 3,721,987.88	Foreign Expenses (2) 297,982.27	Net Dividend Income	Limitation 131 (f) Net Income (3) 7,726,586.25	Limitation 131 (f) U. S. Tax (4) 1,854,380.70	Deemed Per Schedule	Credit Allowable		131 (a) Foreign Currency	131 (a) Rate	131 (a) Dollars
						%							
Argentina—Refinerias de Mais, S.R.L.	650,000.00	153,400.00	4.121453	12,281.20	141,118.80	1.826406	33,868.52	—	—	Arg. Peso	34,423.30	.2360	8,123.90
Brazil—Maizena Brasil, S.A.	2,100,000.00	101,448.93	2.725665	8,122.00	93,326.93	1.207868	22,398.47	5,818.84	5,818.84	Milreis	168:000$000	20$700	8,115.93
Canada—The Canada Starch Company, Ltd.	92,690.50	83,504.87	2.243556	6,685.40	76,819.47	.994223	18,436.68	21,901.63	18,436.68	Canadian $	4,634.53	.90090	4,175.25
	19,155.00	17,256.74	.463643	1,381.57	15,875.17	.205462	3,810.05	5,697.63	3,810.05		957.75	.90089	862.83
	19,155.00	17,256.74	.463643	1,381.57	15,875.17	.205462	3,810.05	5,697.63	3,810.05		957.75	.900997	862.93
	92,690.50	83,504.87	2.243556	6,685.40	76,819.47	.994223	18,436.68	27,570.65	18,436.68		4,634.53	.90090	4,175.25
		201,523.22							44,493.46		11,184.56		10,076.26
Egypt—Corn Products Company, S.A.	1,250.00	5,133.46	.137923	410.99	4,722.47	.061120	1,133.40	—	—	Eg. b	100.00	4.1068	410.68
England—Corn Products Company, Ltd.	65,625.00	256,757.81	6.898405	20,556.02	236,201.79	3.057001	56,688.44	73,212.11	56,688.44		—		—
	50,000.00	174,312.50	4.683317	13,955.45	160,357.05	2.075393	38,485.69	57,419.41	38,485.69		—		—
	37,500.00	150,750.00	4.050255	12,069.04	138,680.96	1.794854	33,283.43	63,518.29	33,283.43		—		—
		581,820.31							128,457.56				
Germany—Deutsche Maizena Werke A.G.	420,000.00	40,320.00	1.083292	3,228.02	37,091.98	.480056	8,902.07	21,273.67	8,902.07	Marks	42,000.00	.096	4,032.00
Deutsche Maizena Gesellschaft m.b.H.	420,000.00	40,320.00	1.083292	3,228.02	37,091.98	.480056	8,902.07	17,023.86	8,902.07		42,000.00	.096	4,032.00
Maizenahaus Gesellschaft m.b.H.	60,000.00	5,760.00	.154756	461.15	5,298.85	.068579	1,271.72	1,607.10	1,271.72		6,000.00	.096	576.00
Mondamin Gesellschaft m.b.H.	36,000.00	3,456.00	.092854	276.69	3,179.31	.041148	763.04	1,405.03	763.04		3,600.00	.096	345.60
Transport und Lagerhaus Gesellschaft m.b.H.	58,500.00	5,616.00	.150887	449.62	5,166.38	.066865	1,239.93	1,918.81	1,239.93		5,850.00	.096	561.60
Finkenheerder Obstwerke R.S.,A.G.	10,800.00	1,036.80	.027856	83.01	953.79	.012344	228.90	—	—		1,080.00	.096	103.68
C. H. Knerr A. G.	50,944.00	4,890.62	.131398	391.54	4,499.08	.058229	1,079.79	—	—		5,094.40	.096	489.06
		101,399.42							21,078.83		105,624.00		10,139.94
Holland—N.V. Corn Products Company	155,964.00	82,511.01	2.216853	6,605.83	75,905.18	.982390	18,217.25	4,354.11	4,354.11		—		—
N.V. Stijfeel en Glucose Fabriek	323,400.00	171,678.83	4.612557	13,744.60	157,934.23	2.044036	37,904.21	5,547.84	5,547.84		—		—
	207,900.00	110,584.92	2.971125	8,853.43	101,731.49	1.316642	24,415.56	5,475.44	5,475.44				
		364,774.76							15,377.39				
India—Corn Products Company, Ltd.	50,000.00	14,903.15	.400408	1,193.14	13,710.01	.177439	3,290.39	7,052.75	3,290.39		—		—
Japan—Nippon Kukusan Kegye Kabushiki Kaisha	722,000.00	169,191.67	4.545734	13,545.48	155,646.19	2.014424	37,355.09	50,774.34	37,355.09	Yen	76,906.40	.234448	18,030.59
Switzerland—Corn Products Company, Ltd.	12,000.00	2,724.18	.073192	218.10	2,506.08	.032435	601.47	1,307.87	601.47	Sw. Fe.	720.00	.227015	163.45
Yugoslavia—A.D.Za Preradu Kukuruza	506,000.00	4,731.46	.127122	378.80	4,352.66	.056334	1,044.65	2,365.73	1,044.65	Dinar	106,260.00	.0093507	993.61
		1,701,050.56	45.702742	136,186.07	1,564,864.49	20.252989	375,567.55	380,942.74	257,517.68				56,054.36

(1) As per total gross income on 131 (b) (1) schedule

(2) Ratable expenses (from 131 (b) (1) schedule) 146,931.21
Foreign general expense (as adjusted) 151,051.06
297,982.27

(3) Corn Products Refining Company normal tax net income

(4) Corn Products Refining Company (before consolidation) total income and income defense tax

CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED RETURN
17 BATTERY PLACE NEW YORK, N. Y.

CORPORATION INCOME, DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN 1940

CORN PRODUCTS REFINING COMPANY
COMPUTATION OF FOREIGN TAX CREDIT UNDER SECTION 131 (a) and 131 (f)

	Dividend Foreign Currency	Dividend	% of Gross Income Positive Items (1) 3,721,987.88	Foreign Expenses (2) 297,982.27	Net Dividend Income	Limitation 131 (f) Net Income (3) 7,726,586.25	Limitation 131 (f) U. S. Tax (4) 1,854,380.70	Deemed Per Schedule	Credit Allowable		131 (a) Foreign Currency	131 (a) Rate	131 (a) Dollars
						%							
Argentina—Refinerias de Mais, S.R.L.	650,000.00	153,400.00	4.121453	12,281.20	141,118.80	1.826406	33,868.52	—	—	Arg. Peso	34,423.30	.2360	8,123.90
Brazil—Maizena Brasil, S.A.	2,100,000.00	101,448.93	2.725665	8,122.00	93,326.93	1.207868	22,398.47	5,818.84	5,818.84	Milreis	168:000$000	20$700	8,115.93
Canada—The Canada Starch Company, Ltd.	92,690.50	83,504.87	2.243556	6,685.40	76,819.47	.994223	18,436.68	21,901.63	18,436.68	Canadian $	4,634.53	.90090	4,175.25
	19,155.00	17,256.74	.463643	1,381.57	15,875.17	.205462	3,810.05	5,697.63	3,810.05		957.75	.90089	862.83
	19,155.00	17,256.74	.463643	1,381.57	15,875.17	.205462	3,810.05	5,697.63	3,810.05		957.75	.900997	862.93
	92,690.50	83,504.87	2.243556	6,685.40	76,819.47	.994223	18,436.68	27,570.65	18,436.68		4,634.53	.90090	4,175.25
		201,523.22							44,493.46		11,184.56		10,076.26
Egypt—Corn Products Company, S.A.	1,250.00	5,133.46	.137923	410.99	4,722.47	.061120	1,133.40	—	—	Eg. b	100.00	4.1068	410.68
England—Corn Products Company, Ltd.	65,625.00	256,757.81	6.898405	20,556.02	236,201.79	3.057001	56,688.44	73,212.11	56,688.44		—		—
	50,000.00	174,312.50	4.683317	13,955.45	160,357.05	2.075393	38,485.69	57,419.41	38,485.69		—		—
	37,500.00	150,750.00	4.050255	12,069.04	138,680.96	1.794854	33,283.43	63,518.29	33,283.43		—		—
		581,820.31							128,457.56				
Germany—Deutsche Maizena Werke A.G.	420,000.00	40,320.00	1.083292	3,228.02	37,091.98	.480056	8,902.07	21,273.67	8,902.07	Marks	42,000.00	.096	4,032.00
Deutsche Maizena Gesellschaft m.b.H.	420,000.00	40,320.00	1.083292	3,228.02	37,091.98	.480056	8,902.07	17,023.86	8,902.07		42,000.00	.096	4,032.00
Maizenahaus Gesellschaft m.b.H.	60,000.00	5,760.00	.154756	461.15	5,298.85	.068579	1,271.72	1,607.10	1,271.72		6,000.00	.096	576.00
Mondamin Gesellschaft m.b.H.	36,000.00	3,456.00	.092854	276.69	3,179.31	.041148	763.04	1,405.03	763.04		3,600.00	.096	345.60
Transport und Lagerhaus Gesellschaft m.b.H.	58,500.00	5,616.00	.150887	449.62	5,166.38	.066865	1,239.93	1,918.81	1,239.93		5,850.00	.096	561.60
Finkenheerder Obstwerke R.S.,A.G.	10,800.00	1,036.80	.027856	83.01	953.79	.012344	228.90	—	—		1,080.00	.096	103.68
C. H. Knerr A. G.	50,944.00	4,890.62	.131398	391.54	4,499.08	.058229	1,079.79	—	—		5,094.40	.096	489.06
		101,399.42							21,078.83		105,624.00		10,139.94
Holland—N.V. Corn Products Company	155,964.00	82,511.01	2.216853	6,605.83	75,905.18	.982390	18,217.25	4,354.11	4,354.11		—		—
N.V. Stijfeel en Glucose Fabriek	323,400.00	171,678.83	4.612557	13,744.60	157,934.23	2.044036	37,904.21	5,547.84	5,547.84		—		—
	207,900.00	110,584.92	2.971125	8,853.43	101,731.49	1.316642	24,415.56	5,475.44	5,475.44				
		364,774.76							15,377.39				
India—Corn Products Company, Ltd.	50,000.00	14,903.15	.400408	1,193.14	13,710.01	.177439	3,290.39	7,052.75	3,290.39		—		—
Japan—Nippon Kukusan Kegye Kabushiki Kaisha	722,000.00	169,191.67	4.545734	13,545.48	155,646.19	2.014424	37,355.09	50,774.34	37,355.09	Yen	76,906.40	.234448	18,030.59
Switzerland—Corn Products Company, Ltd.	12,000.00	2,724.18	.073192	218.10	2,506.08	.032435	601.47	1,307.87	601.47	Sw. Fe.	720.00	.227015	163.45
Yugoslavia—A.D.Za Preradu Kukuruza	506,000.00	4,731.46	.127122	378.80	4,352.66	.056334	1,044.65	2,365.73	1,044.65	Dinar	106,260.00	.0093507	993.61
		1,701,050.56	45.702742	136,186.07	1,564,864.49	20.252989	375,567.55	380,942.74	257,517.68				56,054.36

Exhibit 12-H.

AFFILIATIONS SCHEDULE

To be filed with each Consolidated Income Tax Return of Railroad Corporations or Pan-American Trade Corporations (see Section 23.12 of Regulations 104)

TAXABLE YEAR ENDED December 31, 1940

Common parent corporation Corn Products Refining Company.

Address 17 Battery Place, New York, N. Y.

An affiliated group of railroad corporations, within the meaning of section 141 of the Internal Revenue Code, is formed at the time that the common parent corporation becomes the owner directly of at least 95 percent of the stock (not including nonvoting stock which is limited and preferred as to dividends) of another corporation. A corporation becomes a member of such an affiliated group at the time that one or more members of such group becomes the owners directly of at least 95 percent of its stock. A corporation ceases to be a member of such an affiliated group at the time that the aggregate of its stock owned directly by the members of such group becomes less than 95 percent. See section 141 of the Internal Revenue Code and sections of Regulations 103 pertaining thereto.

A Pan-American affiliated group of corporations, within the meaning of section 152 of the Internal Revenue Code, is formed at the time that the common parent corporation satisfying the conditions imposed by such section becomes the owner directly of 100 percent of the capital stock of another corporation satisfying the conditions imposed by such section. A corporation satisfying the conditions so imposed becomes a member of a Pan-American affiliated group at the time that the common parent corporation becomes the owner directly of 100 per cent of its capital stock. A corporation ceases to be a member of a Pan-American affiliated group at the time that some portion of its capital stock ceases to be owned directly by the common parent corporation, or as of the first day of the taxable year during which such corporation ceases to satisfy the conditions made essential to its classification by section 152. See section 152 of the Internal Revenue Code and sections of Regulations 103 pertaining thereto.

No.	NAME AND ADDRESS OF CORPORATION	Date of Incorporation	State or Country in which Incorporated	CAPITAL STOCK OUTSTANDING AT BEGINNING OF YEAR			STOCK HOLDINGS AT BEGINNING OF YEAR		
					Par Value				Owned by Corporation Number—
					Per Share	Total	Number of Shares	Per Cent	
	Common parent corporation:								
1	Corn Products Refining Company	2-6-1906	Com N. J. Pfd		$25. 100.	63,250,000.00 25,000,000.00			
	Subsidiary corporation:								
2	Refinacoes de Milho	11-16-26	N. J.		100.	100,000.00	1,000	100	1

Exhibit 12-H.

CORN PRODUCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED I
17 BATTERY PLACE, NEW YORK, N. Y.

CORPORATION INCOME DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETU

CORN PRODUCTS REFINING COMPANY
COMPUTATION OF FOREIGN TAX CREDIT UNDER SECTION 131 (b) (1)

	Dividends	Royalties	Interest	Purchase and Sale	Cap. Gain	Other Income	Gross Income	Foreign Exchange Dr. Cr.	A Revised Foreign Gross Income	Adjustment for ratable expenses Red Figures	Total Gross Income	%	B $	C Foreign General Expense	Pension Insurance
Argentina	153,400.00	19,211.50		16,135.02			188,746.52	12,384.62	176,361.90	12,384.62	188,746.52	5.071121	7,451.06	2,780.56	
Australia														107.12	
Austria															
Belgium								444.76	444.76	444.76				134.74	Figures not available at time of filing return
Brazil	101,448.93			4,197.84		14,805.49	120,452.26	22,184.79	98,267.47	22,184.79	120,452.26	3.230235	4,755.04	3,407.55	
Canada	201,523.22		786.80	75.46		*25,714.22	233,085.07	.08	233,085.15		233,085.15	6.278503	9,225.08	253.44	
Canary Islands						5,585.37									
China								2,867.63	2,867.63	2,867.63				4,986.06	
Colombia		8,826.20					8,826.20	13.25	8,812.95	13.25	8,826.20	.237137	348.43	1,116.45	
Cuba								2,464.74	2,464.74	2,464.74				19.60	
Czechoslovakia						1,900.00	1,900.00	104.32	2,004.32		2,004.32	.053851	79.12	8.67	
Denmark								755.42	755.42	755.42				4.17	
Dominican Republic															
Dutch East Indies															
Egypt	5,133.46					1,403.00	6,598.46	4.46	6,594.00	4.16	6,598.46	.177283	200.48	201.10	
England	581,820.31	1,672.95	2,350.59			2,280.00	588,123.85	11,998.33	576,125.52	11,998.33	588,123.85	15.801337	23,247.10	22,151.28	
France				1,875.00			1,875.00	14,223.39	12,348.39	14,223.39		.050376	74.02	23,545.08	
Germany	101,390.42	334,889.32	30,523.52	10,963.99	1,344,417.25		1,828,225.53	2,084,072.11	255,846.58	2,084,072.11	1,828,225.53	49.119546	72,171.94	14,721.54	
Greece															
Holland	364,774.76		9.76	2.68			364,787.20	3,106.13	367,893.33		367,893.33	9.883824	14,523.16	673.65	
Hungary															
India	14,903.15		7.83			1,091.94	16,002.92	9,277.88	25,280.80		25,280.80	.679228	998.00	931.19	
Italy			20.71	7.65	130,610.00		130,623.06	11,998.33	116,624.73	116.51	130,623.06	3.670741	5,393.41	23,351.61	
Japan	169,191.67		543.21	4,928.38			174,663.26	302.74	174,360.52		174,663.26	4.690875	6,907.05	117,977.76	
Mexico		18,672.84	7,141.16			4,666.66	30,480.66	84.64	30,565.30		30,565.30	.821209	1,208.61	5,143.90	
Netherlands East Indies								1,319.23	1,319.23	1,319.23				11.46	
New Zealand								1,908.50	1,908.50	1,908.50					
Nicaragua															
Others			2.38				2.38	3,093.44	3,091.06	3,093.44	2.38	.000064	.09	17,758.56	
Philippine Islands														6,667.88	
Poland															
Puerto Rico														404.32	
Portugal															
Santo Domingo														376.76	
South Africa								45.21	45.21	45.21				.50	
Switzerland	2,724.18		306.99				2,417.19	4.34	2,412.85	4.34	2,417.19	.061944	.95.42	225.75	
Turkey															
Yugoslavia	4,731.46					973.07	5,704.53	11,826.51	6,121.98	11,826.51	5,704.53	.153266	225.20	997.05	
	1,701,050.56	383,272.84	41,078.97	44,200.72	1,481,027.25	58,481.75	3,709,112.09	2,156,941.45	1,552,170.64	2,169,817.24	3,721,987.88	100.0 0000	146,931.21	151,051.06	
Item #, on return	12.	10	7	13	11	2 & 13									

Revised Foreign Gross Income	1,552,170.64
Revised Total Gross Income	17,895,399.26
% Fgn. of Gross	.8671778%
Total expense to be allocated	4,559,918.96
Total expense allocated to fgn.	138,205.21
Group Insurance	8,539.00
	146,931.21

*Canada Starch Co. free—cr. G.E.M.

Exhibit 12-H.

UCTS REFINING COMPANY AND REFINACOES DE MILHO CONSOLIDATED RETURN
17 BATTERY PLACE NEW YORK, N. Y.

ON INCOME DECLARED VALUE EXCESS-PROFITS AND DEFENSE TAX RETURN—1940

CORN PRODUCTS REFINING COMPANY
COMPUTATION OF FOREIGN TAX CREDIT UNDER SECTION 131 (b) (1)

A Revised Foreign Gross Income	Adjustment for ratable expenses Red Figures	Total Gross Income	%	B $	C Foreign General Expense	Pension Insurance	Profit Sharing	Net Income A (B + C)	Foreign Tax Credit Computation: Interest	131 (a) Royalties	Dividends	131 f Dividends	(a) + (f)	131 (b) (1) 7,726,586.25	Limitation 1,854,380.70	Credit Allowable
176,361.90	12,384.62	188,746.52	5.071121	7,451.06	2,780.56			106,130.28		960.58	8,123.90		9,084.48	2,150112	39,871.26	90,084.48
					107.12			107.12								
444.76	444.76				134.74			579.50								
98,267.47	22,184.79	120,452.26	3.230235	4,755.04	3,407.55	Figures not available at time of filing return		90,104.88		8,115.93		5,818.84 D	5,818.84	1,166167	21,625.18	5,818.84
233,085.15		233,085.15	6.278503	9,225.08	253.44			224,206.63		10,076.26		44,403.46	54,569.72	2,901756	53,809.60	53,809.60 L
2,867.63	2,867.63				4,986.06			7,853.69								
8,812.95	13.25	8,826.20	.237137	348.43	1,116.45			7,348.07		306.63			306.63	.095101	1.763.53	306.63
2,464.74	2,464.74				19.60			2,484.34								
2,004.32		2,004.32	.053851	79.12	8.67			1,916.53						.024804	459.96	
755.42	755.42				4.17			759.59								
6,594.00	4.16	6,598.46	.177283	200.48	201.10			6,132.42			410.68		410.68	.070368	1,471.78	410.68
576,125.52	11,998.33	588,123.85	15.801337	23,247.10	22,151.28			530,727.14		704.92		128,457.56	129,162.48	6.839232	127,381.71	127,381.71 L
12,348.39	14,223.39	1,875.00	.050376	74.02	23,545.08			35,967.49								
255,846.58	2,084,072.11	1828,225.53	49.119546	72,171.94	14,721.54			342,742.06		33,488.93	10,139.94	21,078.83	64,707.70			
367,893.33		367,893.33	9.883824	14,523.16	673.65			372,696.52				15,377.39 D	15,377.39	4.564713	84,647.16	15,377.39
25,280.80		25,280.80	.679228	998.00	931.19			23,351.61				3,290.39	3,290.39	.392224	5,004.38	3,290.39
130,506.55	116.51	130,623.06	3.670741	5,393.41	18,135.38			117,977.76						1.528907	28,314.67	
174,966.00		174,966.00	4.690875	6,907.05	31,287.30			136,771.65			18,030.59	37,355.09	55,385.68	1.770143	32,825.19	32,825.19 L
30,565.30		30,565.30	.821209	1,208.61	5,143.90			24,214.79	1,278.67	2,133.08			3,411.75	.313396	5,811.55	3,411.75
1,319.23	1,319.23							1,319.23								
1,908.50	1,908.50				11.46			2,009.96								
3,091.06	3,093.44	2.38	.000064	.09	17,758.56			20,849.71								
					6,667.88			6,667.88								
					404.32			404.32								
					376.76			376.76								
45.21	45.21				.50			45.71								
2,412.85	4.34	2,417.19	.061944	.95.42	225.75			2,091.08			163.45	601.47	764.92	.027071	502.00	502.00 L
6,121.98	11,826.51	5,704.53	.153266	225.20	997.05			7,344.23			963.61	1,044.65	2,038.26			
1,552,170.64	2,169,817.24	3,721,987.88	100.0 0000	146,931.21	151,051.06			1,254,188.37	1,278.67	37,504.14	50,054.36	257,517.68	352,444.85			252,218.66

Foreign Gross Income	1,552,170.64
Total Gross Income	17,895,399.26
% of Gross	.8671778%
Expense to be allocated	1,559,918.96
Expense allocated to fgn.	138,205.21
Insurance	8,539.00
	146,931.21

Petitioner's Exhibit 13.

445

2996

FEED CONTRACT

CORN PRODUCTS SALES COMPANY
17 Battery Place

Eastern States Milling Co.,
Ontario St. & Cloverdale Rd.,
Buffalo, N. Y.

New York, May 17, 1939.

Dear Sir:

446

We hereby confirm upon the following terms and conditions your order received through C. J. Irwin Co., Inc. 482-661 for

1800 tons Buffalo Corn Gluten Feed Bulk @ first price and terms announced for month taken
4200 tons Diamond Corn Gluten Meal Bulk @ " " " " " nounced for month taken
350 tons Diamond Corn Gluten Meal Bulk each month, June 1939 to May 1940
150 " Buffalo Corn Gluten Feed Bulk " " " " " " "
Boston basis
Directions later

TERMS OF PAYMENT: Draft payable in 3 days thru M. & T. Trust Co., Buffalo, NY

447

If at any time before delivery the financial responsibility of buyer becomes impaired or unsatisfactory to the seller, cash payment or satisfactory security may be required by the seller before delivery.

SHIPMENT: At seller's option. June 1939 to May 1940

F. O. B. cars at point of shipment, freight prepaid—deduct Buffalo to Boston freight.

PRICE GUARANTEE: Guaranteed against our lower price in your market on date of shipment.

Buyer to pay any advance in freight rate in effect when shipment is made. If lower freight is in effect when shipment is made—buyer to get the benefit.

This sale is made on the basis of factory weights.

Any duty, excise or other tax or charge, Federal, State or Municipal, hereinafter imposed on the products covered hereby, or their manufacture, refining or sale, shall be added to the price herein specified.

Petitioner's Exhibit 13.

448 Seller shall in no case be held responsible for demurrage or storage charges at destination, or for any damages arising from delayed shipments caused by strikes, accidents, car shortage, inability to procure supplies or interruptions of manufacture beyond his control.

Seller not to be responsible for the adaptability of the goods to be delivered on this contract for any specific purpose unless specially and separately provided for in this contract.

SELLER RESERVES the right to ship from any factory and to select the route.

It is agreed that the goods sold under this contract are for consumption in the United States only and not for export.

Respectfully yours,

449 CORN PRODUCTS SALES CO.
Per C. KAYHART
East. Sales Manager.

EASTERN STATE MLG CORP
Accepted H. N. Hasteller

H.D.

Date May 20, 1939.

Please sign this confirmation and return.

450

151

Petitioner's Exhibit 14.

451

STRATTON GRAIN COMPANY
BOARD OF TRADE BUILDING

Chicago, ...

.....

.....

In accordance with your instructions, we have this day *BOUGHT* for your account and risk:

Quantity	Delivery	Article	Price	From Whom Bought

452

All transactions made by us for your account contemplate the actual receipt and delivery of the property and payment therefor.

In order to have your contract for future delivery of property stand open until such delivery occurs, you must keep deposited with us funds to protect us against intervening changes in the value of the property; and in case such funds become in our judgment at any time insufficient for such protection, you understand that you authorize us to dispose of your contracts on the open market without further notice to you.

453

We also reserve the privilege of substituting at any time other parties as principals with you in following your trades until consummated by delivery or otherwise disposed of.

All purchases and sales made by us for you are made in accordance with and subject to the rules, regulations and customs of the Exchange in which the trades are made, and all amendments that may be made thereto.

We will only be responsible for communications addressed to the

STRATTON GRAIN COMPANY
J-17

Per .....

Petitioner's Exhibit 15.

454

STRATTON GRAIN COMPANY
BOARD OF TRADE BUILDING

Chicago, ...

.....

.....

In accordance with your instructions, we have this day *SOLD* for your account and risk:

Quantity	Delivery	Article	Price	To Whom Sold
455				

All transactions made by us for your account contemplate the actual receipt and delivery of the property and payment therefor.

In order to have your contract for future delivery of property stand open until such delivery occurs, you must keep deposited with us funds to protect us against intervening changes in the 456 value of the property: and in case such funds become in our judgment at any time insufficient for such protection, you understand that you authorize us to dispose of your contracts on the open market without further notice to you.

We also reserve the privilege of substituting at any time other parties as principals with you in following your trades until consummated by delivery or otherwise disposed of.

All purchases and sales made by us for you are made in accordance with and subject to the rules, regulations and customs of the Exchange in which the trades are made, and all amendments that may be made thereto.

We will only be responsible for communications addressed to the

STRATTON GRAIN COMPANY.

Per .....

J-18

Petition for Review.

457

THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 202

CORN PRODUCTS REFINING COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent. 458

To the Honorable Judges of the United States Court of Appeals for the Second Circuit.

COMES NOW Corn Products Refining Company by its attorneys, Jay O. Kramer, Esq., and Samuel A. McCain, Esq., and respectfully shows:

I.

JURISDICTION

459

That petitioner is a corporation organized under the laws of the State of New Jersey on February 6, 1906, with its principal office at 17 Battery Place, New York 4, New York.

That the consolidated income tax return for the calendar year 1940 was filed with the Collector of Internal Revenue, Second District of New York, whose office is within the jurisdiction of this honorable Court. The Court in which review of this cause is sought is the United States Court of Appeals for the Second Circuit.

The petitioner files this Petition for review pursuant

460 to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

2.

NATURE OF THE CONTROVERSY

The nature of the controversy is as follows:

Petitioner is a corporation organized under the laws of the State of New Jersey on February 6, 1906. It filed its consolidated income tax return for the year 1940 with
461 the Collector of Internal Revenue, Second District, New York. The taxes in controversy are income taxes. The amount of the deficiency asserted by respondent in his notice of deficiency is $163,804.78. On the other hand, petitioner claims that it has overpaid its tax for such year.

Petitioner is a nationally-known corporation engaged in the manufacture and sale of corn products, including starches, sugars, syrups, oils and feeds. The maximum amount of raw corn which petitioner could store in its own plants during 1940 was 2,303,000 bushels, or approximately a three weeks' supply. The daily grind capacity of peti-
462 tioner's plants during 1940 was 147,700 bushels. Similar conditions existed in prior years. It had been the custom of petitioner for a number of years prior to 1940 to purchase corn futures contracts. A corn future consists of a contract to buy futures contracts. A corn future consists of a contract to buy 5,000 bushels of corn, or some multiple thereof, of a stated quality, at a stated price, for delivery during a stated month in the future. Such contracts called for delivery within eleven months or less from the date of the contract. Such contracts are freely dealt with on various commodity exchanges, through brokers. The buyer furnishes his broker with margin, a percentage of the contract price.

During the years prior to 1940, petitioner engaged in 463
the purchase and sale of corn futures. It was found to be
far less expensive to purchase corn futures by putting
up a small amount of margin than to buy and store addi-
tional raw corn beyond petitioner's own limited capacity.
The margin charges of futures contracts were less than
storage and carrying charges in public elevators. This
program also avoided financing the purchase of raw
corn by large bank loans.

The corn futures contracts were not sold to customers
in the regular course of petitioner's business but were
disposed of through brokers on a regulated exchange,
nor were such contracts included in inventory, neither 464
were they subject to depreciation.

Petitioner suffered severe losses in the droughts of
1934 and 1936 when the price of corn rose sharply. One
of its major products, cerelose, a refined corn sugar, com-
petes with cane and beet sugar. Since it is a comparatively
new sugar, less sweet than cane or beet, its price to the
consumer is generally less than beet or cane sugar with
which it competes. The two droughts caused the cost of
cerelose to rise out of proportion to its selling price. As
a result in 1937, petitioner lost money on its cerelose
sales. In an attempt to meet this condition, petitioner
envisioned a plan or program in 1937 whereby it would 465
buy corn futures whenever it considered the price of corn
cheap, and would establish a long futures position in the
neighborhood of 12,000,000 bushels. This position would
be built up and maintained during the year until it could
be ascertained to some degree of certainty that no
drought was likely to occur. The position would then
be liquidated in part when, usually in July, favorable
crop conditions were forecast.

The proposed plan was never put into full operation.
Petitioner found it economically impractical to build up
and carry the planned long position of 12,000,000 bushels.

466 The Commodity Exchange Authority intervened in petitioner's program and objected to the size of petitioner's position in 1938. A complaint was brought by that Authority which was dismissed in 1940.

In 1939, the outbreak of the European war rendered any plan unnecessary. The price of cane and beet sugar rose substantially due to war conditions, carrying with it the price of cerelose. The need to stabilize the cost of cerelose thereupon disappeared. The petitioner never was able to put its plan or program into full effect.

The petitioner's accounting practice was to account for its profits or losses on corn futures in an account called
467 "Corn Miscellaneous", the balance in that account at the end of each year was debited or credited to cost of sales. In 1940, the profit balance of $680,587.39 was treated in petitioner's return as a reduction of the "cost of goods sold". In the two previous years, 1938 and 1939, the transactions had resulted in losses of $815,462.57, and $424,437.54, respectively.

The general sales policy of petitioner at all times material, was to enter into contracts providing for shipment within thirty days. A price was named but a provision was made that if the market price in effect on the date
468 of delivery was lower, the buyer was to have the advantage of such lower price.

The questions in controversy are two:

1. Whether the purchase and sale of corn futures contracts by this petitioner were capital transactions, subject to the limitations of Section 117 of the Internal Revenue Code, or whether the gains and losses were from "hedges", resulting in ordinary income and ordinary deductions.

2. Whether the provisions of Section 118 which concerns "wash sales" has application to the corn futures

transactions carried on by petitioner. Respondent. find- 469
ing that neither Section 117 nor Section 118 applied, determined a deficiency of $163,804.78 for the year 1940 against petitioner.

3.

PETITION FOR REVIEW

On the 17th day of September, 1948, petitioner filed with The Tax Court of the United States its petition for redetermination of deficiency. Respondent filed his answer on November 1, 1948. The proceeding came on for 470
hearing June 13, 1950, and on February 20, 1951, the Court promulgated its opinion. It held that petitioner's transactions in corn futures were not subject to the "wash sales" provisions of Section 118 of the Internal Revenue Code. The Court found it unnecessary to pass upon the question of whether such transactions constituted "hedges" and made no ruling with respect to Section 117.

The Court entered its decision on the 15th day of June, 1953, and decided that there is a deficiency of $80,731.19 for the year 1940 in income tax. 471

4.

ASSIGNMENT OF ERRORS

Petitioner assigns as errors the following acts and omissions of The Tax Court of the United States:

1. The finding of The Tax Court of the United States that the transactions of petitioner in corn futures contracts during the year 1940 were not capital transactions under Section 117 of the Internal Revenue Code.

472 2. The finding of The Tax Court of the United States that the "wash sales" provisions of Section 118 of the Internal Revenue Code did not apply to petitioner's transactions in corn futures contracts in 1940.

WHEREFORE, your petitioner petitions that the decision of The Tax Court of the United States be reviewed by the United States Court of Appeals for the Second Circuit; that a transcript of the record be prepared in accordance with the rules of said Court and transmitted to the Clerk of said Court for filing; that proper action be taken to the end that the errors complained of may be
473 reviewed by said Court.

Respectfully submitted,

/s/ JAY O. KRAMER
Jay O. Kramer
c/o Milton M. Bernard
30 East 40th Street
New York, New York

/s/ SAMUEL A. McCAIN
Samuel A. McCain
474 17 Battery Place
New York 4, New York

(Verified June 23, 1953.)

Notice of Filing Petition for Review.

475

[SAME TITLE.]

To: KENNETH W. GEMMILL, Acting
Chief Counsel,
Bureau of Internal Revenue.

You are hereby notified that the above-named petitioner did, on the 25th day of June, 1953, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Second Circuit, of the decision of this Court heretofore rendered in the above-entitled case. Copy of the petition for review as filed is hereto attached and served upon you. 476

Dated this 25th day of June, 1953.

(Signed) VICTOR S. MERSCH, Clerk
Victor S. Mersch, Clerk,
The Tax Court of the United States.

Service of copy of Petition for Review acknowledged this 25th day of June, 1953. 477

KENNETH W. GEMMILL
C. A. R.
Chief Counsel.
Bureau of Internal Revenue,
Attorney for Respondent.

478 **Designation of Contents of Record on Review.**

[SAME TITLE.]

To the Clerk of the Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Court of Appeals for the Second Circuit copies duly certified as correct of the following documents and records in connection with the petition for review heretofore filed by petitioner in the above entitled
479 cause:

1. Docket entries of all proceedings before The Tax Court.

2. Pleadings before the Tax Court:

(a) Petition filed the 20th day of September 1948, including annexed copy of deficiency letter and statement attached thereto.

(b) Answer.

480 3. Findings of Fact, Opinion and Decision.

4. Official Report of Proceedings before The Tax Court, together with all exhibits in evidence and the partial stipulation of facts.

5. Petition for review, together with proofs of service of notice of filing and of service of a copy of petition for review.

6. This Designation of Contents of Record on Review.

Said transcript is to be prepared, certified and transmitted as required by law, and the rules of The United States Court of Appeals for the Second Circuit. 481

JAY O. KRAMER
Jay O. Kramer
Attorney for Petitioner on Review
c/o Milton M. Bernard
10 East 40th Street
New York 16, N. Y.

/s/ SAMUEL A. McCAIN
Samuel A. McCain 482
Attorney for Petitioner on Review
17 Battery Place
New York 4, N. Y.

Admission of Service:

Receipt is hereby acknowledged and service is accepted this 8th day of July 1953 of the Designation of Contents of Record on Review filed in the above entitled cause.

(Signed) KENNETH W. GEMMILL CAR
Acting Chief Counsel
Bureau of Internal Revenue 483
Attorney for Respondent on Review

Certificate.

484

THE TAX COURT OF THE UNITED STATES
Washington

Docket No. 20399

CORN PRODUCTS REFINING COMPANY
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE
Respondent.

485

I, Victor S. Mersch, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 188, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 29th day
486 of July, 1953.

Last day to file record is August 17, 1953.

VICTOR S. MERSCH
Clerk,
The Tax Court of the United States.

(Seal)

TRANSCRIPT OF RECORD IN TAX COURT

DOCKET NO. 22074 (1942).

THE TAX COURT OF THE UNITED STATES.

Docket No. 22074.

487

CORN PRODUCTS REFINING COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

APPEARANCES

488

For Petitioner: JAY O. KRAMER, Esq.
SAMUEL A. McCAIN, Esq.

For Respondent: WARD MANDRY, Esq.

Docket Entries.

1949

Mar 9—Petition received and filed. Taxpayer notified. Fee paid.

Mar 9—Request for hearing in New York filed by taxpayer. Granted 3/25/49.

489

Mar 10—Copy of petition served on General Counsel.

Apr 14—Answer filed by General Counsel.

Apr 20—Copy of answer served on Taxpayer.

1951

Mar 13—Hearing set June 18, 1951, New York.

Mar 15—Entry of appearance of Jay O. Kramer as counsel filed.

490 Jun 18—Hearing had before Judge Opper on the merits. Stipulation of Facts with Exhibits 1-A thru 5-E, Supplemental Stipulation of Facts (Amended) filed. Appearance of Samuel A. McCain as counsel filed. Briefs due Aug. 17, 1951; replies due Oct. 1, 1951.

Jul 9—Transcript of hearing 6/18/51 filed.

Aug 8—Motion for extension to Aug. 27, 1951 to file original briefs and Oct. 11, 1951 to file reply briefs filed by taxpayer. Granted 8/13/51.

491 Aug 15—Brief filed by taxpayer. Copy served 8/17/51.

Aug 16—Brief filed by General Counsel.

Oct 8—Reply brief filed by taxpayer. Copy served.

Oct 11—Reply brief filed by General Counsel.

1952

Jun 30—Memorandum findings of fact and opinion rendered. Opper *J.* Decision will be entered under Rule 50. Copy served 7/1/52.

Dec 23—Petitioner's computation filed.

492 Dec 30—Hearing set 1/14/53 on petitioner's computation. Copy served.

1953

Jan 2—Respondent's computation filed.

Jan 14—Hearing had before Judge Opper. Record held open to receive motion to reopen case to receive briefs in consideration of the alternative computation now on file. Memorandum filed at hearing. Briefs due Feb. 15, 1953.

Jan 19—Transcript of hearing 1/14/53 filed. 493

Jan 26—Joint motion to reopen case filed. Granted 1/26/53.

Feb 13—Brief filed by taxpayer.

Feb 16—Motion for extension to Feb. 28, 1953, to file brief filed by General Counsel. Granted 2/17/53.

Mar 2—Memorandum brief filed by General Counsel. Copy served 3/4/53.

May 28—Supplemental Opinion rendered, Opper *J.* Decision will be entered under Rule 50. Copy served. 494

Jun 9—Respondent's Computation filed. Agreed to.

Jun 15—Decision entered, Opper *J.* Div. 14.

Jun 25—Petition for review by U. S. Court of Appeals, Second Circuit, with assignments of error filed by petitioner.

Jun 25—Proof of service filed.

Jul 8—Designation of Contents of Record with Proof of service thereon filed by petitioner.

495

496 **Petition.**

[SAME TITLE.]

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (SN-IT-7), dated December 14, 1948, and as a basis of its proceeding alleges as follows:

497 1. The petitioner is a corporation duly organized under the laws of the State of New Jersey, with its principal office at 17 Battery Place, New York 4, N. Y. The return for the period here involved (1942) was filed with the Collector of Internal Revenue for the Second District of New York.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on December 14, 1948.

498 3. The taxes in controversy are for the calendar year 1942, representing deficiencies claimed by the Commissioner of Internal Revenue of excess profits tax in the sum of $1,520,519.39 and declared value excess-profits tax in the sum of $14,487.94, as against a refund claimed by the petitioner.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner of Internal Revenue erred in understating net income for declared value excess-profits tax computation in the sum of $110,753.23 and in understating excess profits net income computed under income credit method in the sum of $140,575.63. This error resulted from his failure to treat profits and losses realized

by petitioner in 1942 from the purchase and sale of corn futures contracts as capital gains and losses, under Sections 117 and 118 of the Internal Revenue Code. The error comprised an overstatement of "Cost of goods sold" in the sum of $109,969.38, an understatement of recognized net short-term capital gain in the sum of $606.25, and an understatement of recognized net long-term capital gain in the sum of $177.60. 499

(b) The Commissioner of Internal Revenue erred in understating the excess profits credit based on income for 1942 in the sum of $400,983.16. This error resulted from his failure to treat profits and losses realized by petitioner in 1939 from the purchase and sale of corn futures contracts as capital gains and losses, under Sections 117 and 118 of the Internal Revenue Code. This error comprised an overstatement of cost of goods sold in the sum of $424,437.54 and an overstatement of recognized net short-term capital gain in the sum of $2,350.00 in determining the excess profits net income computed under income credit method for 1939. 500

(c) The Commissioner of Internal Revenue erred in understating the excess profits credit based on income for 1942 in the sum of $298,744.75. This error resulted from his failure to disallow the sum of $314,468.16 in determining the excess profits net income computed under income credit method for 1939. The said sum of $314,468.16 represents an abnormal deduction under Section 711 (b) (1) (J) (ii) of the Internal Revenue Code, which was incurred by the petitioner in connection with the purchase and sale of corn futures contracts. This error is alleged in the alternative to errors 4. (a) and 4. (b) hereof. 501

(d) The Commissioner of Internal Revenue erred in understating the excess profits credit based on income for 1942 in the sum of $122,941.88. This error resulted from his failure to include as foreign dividend income

502 the sum of $129,412.50 in determining the excess profits net income computed under income credit method for 1939.

(e) The Commissioner of Internal Revenue erred in understating the excess profits credit based on income for 1942 in the sum of $89,701.73. This error resulted from his failure to include as foreign dividend income the sum of $94,422.87 in determining the excess profits net income computed under income credit method for 1939.

(f) The Commissioner of Internal Revenue erred in understating the unused excess profits credit adjustment
503 for 1942 in the sum of $436,945.36. This error resulted from his failure to exclude from 1941 excess profits net income computed under income credit method the abnormal income excludible under Section 721 of the Internal Revenue Code.

(g) The Commissioner of Internal Revenue erred in understating the unused excess profits credit adjustment for 1942 in the sum of $806,431.32. This error resulted from his failure to treat profits and losses realized by petitioner in 1939 from the purchase and sale of corn futures contracts as capital gains and losses, under Sec-
504 tions 117 and 118 of the Internal Revenue Code, in computing excess profits credit based on income for each of the years 1940 and 1941. This error comprised an overstatement of cost of goods sold in the sum of $424,437.54 in determining the excess profits net income computed under income credit method for 1939.

(h) The Commissioner of Internal Revenue erred in understating the unused excess profits credit adjustment for 1942 in the sum of $597,489.50. This error resulted from his understating the excess profits credit based on income for each of the years 1940 and 1941 by failing to disallow for 1939 the sum of $314,468.16 in determining

the excess profits net income computed under income credit method for 1939. The sum of $314,468.16 represents an abnormal deduction under Section 711 (b) (1) (J) (ii) of the Internal Revenue Code, which was incurred by the petitioner in connection with the purchase and sale of corn futures contracts. This error is pleaded in the alternative to error 4. (g) hereof. 505

(i) The Commissioner of Internal Revenue erred in understating the unused excess profits credit adjustment for 1942 in the sum of $245,883.76. This error resulted from his understating the excess profits credit based on income for each of the years 1940 and 1941, by failing to include the sum of $129,412.50 of Brazilian dividends in determining the excess profits net income computed under income credit method for 1939. 506

(j) The Commissioner of Internal Revenue erred in understating the unused excess profits credit adjustment for 1942 in the sum of $179,403.46. This error resulted from his understating the excess profits credit based on income for each of the years 1940 and 1941, by failing to include the sum of $94,422.87 of Italian dividends in determining the excess profits net income computed under income credit method for 1939. 507

(k) The Commissioner of Internal Revenue erred in understating the unused excess profits credit adjustment for 1942 in the sum of $618,259.29. This error resulted from his failure to treat profits and losses realized by petitioner in 1940 from the purchase and sale of corn futures contracts as capital gains and losses, under Sections 117 and 118 of the Internal Revenue Code, in determining the excess profits net income computed under income credit method for 1940. The error comprised an understatement of cost of goods sold in the sum of $680,587.39 and an understatement of recognized net short-term capital gain in the sum of $62,328.10 in de-

508 terming the excess profits net income computed under income credit method for 1940.

(1) The Commissioner of Internal Revenue erred in understating the unused excess profits credit adjustment for 1942 in the sum of $151,021.86. This error resulted from his failure to treat profits and losses realized by petitioner in 1941 from the purchase and sale of corn futures contracts as capital gains and losses, under Sections 117 and 118 of the Internal Revenue Code, in determining the excess profits net income computed under income credit method for 1941. The error comprised an
509 understatement of cost of goods sold in the sum of $180,056.23 and an understatement of recognized net short-term capital gain in the sum of $29,034.37 in determining the excess profits net income computed under income credit method for 1941.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) (1) In the 1942 return of the petitioner the sum of $109,969.38 representing net loss in 1942, from the purchase and sale of corn futures contracts, was treated as an addition to the cost of goods sold.

510

(2) All such corn futures contracts were purchased through members of a recognized Commodity Exchange in varying quantities. Such contracts were subject to the rules, regulations, and customs of the Commodity Exchange where the trades were made, and, when required, were also made under authority of the Act of Congress known as the "Commodity Exchange Act."

(3) The purchase and sale of such corn futures contracts was confirmed by members of recognized Commodity Exchanges.

(4) The purchase and sale of corn futures contracts

by the petitioner constitutes the purchase and sale of 511
capital assets under the provisions of Section 117(a) of the Internal Revenue Code and does not constitute a part of "Cost of Goods Sold." Such corn futures contracts were (i) not stock in trade or other property properly includible in inventory of the petitioner; (ii) the petitioner did not hold such corn futures contracts primarily for sale to customers in the ordinary course of petitioner's trade or business; and (iii) such corn futures contracts are not property, used in the petitioner's trade or business, of a character which is subject to the allowance for depreciation.

512

(5) The petitioner did not engage in hedging transactions in respect of the corn futures contracts which it purchased, as defined in G. C. M. 17322 and in the decisions of the Courts. Petitioner never sold corn futures contracts against its inventory position and never purchased corn futures contracts to protect long-term sales contracts of its products. Petitioner's purpose in acquiring corn futures contracts was to enable it, on the maturity dates of such contracts, to take in the corn called for therein, if there should be insufficient cash corn available in the market on such maturity dates to meet petitioner's requirements. The petitioner sold such contracts when it 513
became apparent that there would be sufficient cash corn available on their maturity dates to meet its requirements, usually replacing the contracts so sold, shortly before or after each such sale, with other corn futures contracts of later maturity. Infrequently, when petitioner endeavored to sell such a contract, it could not find a buyer and, therefore, had to take in the corn at the maturity date of the contract.

(6) The cost of the corn futures contracts purchased by the petitioner, which contracts were sold during 1942 and which were held for a period of not more than six months

514 (such cost and holding period having been computed without the application of the provisions of Section 118 of the Internal Revenue Code) was $197,598.13 more than their selling price.

(7) The cost of the corn futures contracts purchased by the petitioner, which contracts were sold during 1942 and which were held for a period of more than six months (such cost and holding period having been computed without the application of the provisions of Section 118 of the Internal Revenue Code) was $87,628.75 less than their selling price.

515 (8) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1942 and which were held for a period of not more than six months (such basis and holding period having been computed in accordance with the provisions of Section 118 of the Internal Revenue Code) was $606.25 less than their selling price.

(9) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1942 and which were held for a period of more than six months (such basis and holding period having been computed in
516 accordance with the provisions of Section 118 of the Internal Revenue Code) was $75,163.13 less than their selling price.

(10) The sum of $109,969.38 set forth in paragraph 5, (a) (1) hereof, was treated by the petitioner in its return for 1942, as an addition to the cost of goods sold.

(11) The decisions of the Courts in the matters of (1) *Trenton Cotton Oil Company*, 147 F. (2d) 33 (rehearing denied, 148 F. (2d) 208), (2) *Estate of Dorothy Makransky*, 5 T. C. 397 (affirmed by CCA-3, 154 F. (2d) 59), and (3) *Stewart Silk Corporation*, 9 T. C. 174

(A. 1948-3-12739) were all promulgated after the filing of the petitioner's 1941 and 1942 returns. 517

(12) A corn futures contract is a security. (*Trenton Cotton Oil Company*, 147 F. (2d) 33 (rehearing denied, 148 F. (2d) 208)).

(13) Section 118 of the Internal Revenue Code applicable to wash sales of securities is applicable to losses realized from the sale of corn futures contracts.

(b) (1) In the 1939 return of the petitioner the sum of $424,437.54 representing net loss in 1939, from the purchase and sale of corn futures contracts, was treated as an addition to the cost of goods sold. This amount is the net loss realized during 1939 from the purchase and sale of corn futures contracts under facts and circumstances similar to those alleged in paragraphs 5. (a) (2), 5. (a) (3), 5. (a) (4), 5. (a) (5), 5. (a) (11), 5. (a) (12), and 5. (a) (13) hereof. 518

(2) The cost of the corn futures contracts purchased by the petitioner, which contracts were sold during 1939 and which were held for a period of not more than six months (such cost and holding period having been computed without the application of the provisions of Section 118 of the Internal Revenue Code) was $92,453.09 less than their selling price. 519

(3) The cost of the corn futures contracts purchased by the petitioner, which contracts were sold during 1939 and which were held for a period of more than six months (such cost and holding period having been computed without the application of the provisions of Section 118 of the Internal Revenue Code) was $516,890.63 more than their selling price.

(4) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1939

520 and which were held for a period of not more than six months (such basis and holding period having been computed in accordance with the provisions of Section 118 of the Internal Revenue Code) was $2,350.00 more than their selling price.

(5) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1939 and which were held for a period of more than six months (such basis and holding period having been computed in accordance with the provisions of Section 118 of the Internal Revenue Code) was $242,200.03 more than their
521 selling price.

(6) The sum of $424,437.54 set forth in paragraph 5. (b) (1) hereof, was treated by the petitioner, in its return for 1939, as an addition to the cost of goods sold.

(c) (1) In the returns of the petitioner for the years 1932 through 1942, the following sums, the net gain or net loss in each of said years from the purchase and sale of corn futures contracts, were treated as reductions of or as additions to the cost of goods sold:

522

Year	Net Gain (treated as a reduction of cost of goods sold)	Net Loss (treated as an addition to cost of goods sold)
1932	$	$ 27,943.75
1933	27,531.25	
1934		3,450.00
1935	56,768.75	
1936		165,532.27
1937	590,339.35	
1938		815,462.57
1939		424,437.54
1940	680,587.39	
1941	180,056.23	
1942		109,969.38

Each of the foregoing amounts is the net gain or the net loss realized from the purchase and sale of corn futures contracts during each of the years 1932 through 1942, under facts and circumstances similar to those alleged in paragraphs 5. (a) (2), 5. (a) (3), and 5. (a) (5) hereof. 523

(2) The net gain or the net loss for each year set forth in paragraph 5. (c) (1) hereof, was treated by the petitioner in its returns as a reduction of or an addition to the cost of goods sold.

(3) In the event it is determined that the purchase and sale of corn futures contracts by the petitioner, does not constitute the purchase and sale of capital assets under the provisions of Section 117 (a) of the Internal Revenue Code, then the net gain or the net loss from the purchase and sale of such contracts constitutes, respectively, a reduction of or an addition to "Other Deductions Authorized by Law" and does not constitute a part of "Cost of Goods Sold." The amount of the net gain or the net loss for each year is set forth in paragraph 5. (c) (1) hereof. 524

(4) The amounts set forth in paragraph 5. (c) (1) hereof constitute "Other Deductions Authorized by Law" (paragraph 5. (c) (3) hereof) and meet the requirements of Section 711 (b) (1) (K) (ii) of the Internal Revenue Code in that the above-mentioned amounts are neither the consequence of an increase in the gross income of the taxpayer in its base period nor a decrease in the amount of some other deduction in its base period, and are not a consequence of a change at any time in the type, manner of operation, size, or condition of the business engaged in by the taxpayer. A schedule setting forth the details of the computation of the adjustment of abnormal deductions under Section 711 (b) (1) (J) (ii) of the Internal Revenue Code, "'Other Deductions Authorized by Law' from the purchase and sale of corn futures contracts," is attached and marked Exhibit "B." 525

526 (5) A statement of the facts set forth in paragraph 5. (c) (4) hereof, together with a copy of Exhibit "B," both in duplicate, have been duly submitted to the Commissioner of Internal Revenue, c/o Technical Staff, New York Division, Bureau of Internal Revenue, 23rd Floor, Empire State Building, New York 1, New York.

(d) (1) Maizena Brasil, S. A., a Brazilian corporation, during the year 1939 declared and paid a dividend of 2,175,000,000 Brazilian Milreis to the petitioner, a stockholder thereof.

527 (2) The said dividend set forth in paragraph 5. (d) (1) hereof, constituted taxable foreign dividend income in 1939.

(3) The fair market value and rate of exchange for converting the dividend set forth in paragraph 5. (d) (1) hereof, was $.0595 per Milreis, making a dollar equivalent of $129,412.50.

(4) The said sum of $129,412.50 alleged in paragraph 5. (d) (3) hereof, was not included in petitioner's taxable income for 1939 by either the petitioner or the Commissioner of Internal Revenue.

528 (e) (1) Various Italian corporations, during the year 1939 declared and paid dividends aggregating 4,496,327.00 Italian Lire to the petitioner, a stockholder thereof.

(2) The said dividends set forth in paragraph 5. (e) (1) hereof, constituted taxable foreign dividend income in 1939.

(3) The fair market value and rate of exchange for converting the dividends set forth in paragraph 5. (e) (1) hereof, was $.021 per Lira, making a dollar equivalent of $94,422.87.

(4) The said sum of $94,422.87 alleged in paragraph

5. (e) (3) hereof, was not included in petitioner's taxable income for 1939 by either the petitioner or the Commissioner of Internal Revenue. 529

(f) (1) In determining the petitioner's excess profits net income computed under income credit method for 1941, the Commissioner of Internal Revenue excluded therefrom the sum of $436,945.36 as constituting abnormal income under Section 721 of the Internal Revenue Code.

(g) (1) In the 1939 return of the petitioner the sum of $424,437.54 representing net loss in 1939, from the purchase and sale of corn futures contracts, was treated as an addition to the cost of goods sold. This amount is the net loss realized during 1939 from the purchase and sale of corn futures contracts under facts and circumstances similar to those alleged in paragraphs 5. (a) (2), 5. (a) (3), 5. (a) (4), 5. (a) (5), 5. (a) (11), 5. (a) (12), and 5. (a) (13) hereof. 530.

(2) The cost of the corn futures contracts purchased by the petitioner, which contracts were sold during 1939 and which were held for a period of not more than eighteen months (such cost and holding period having been computed without the application of the provisions of Section 118 of the Internal Revenue Code) was $424,437.54 more than their selling price. 531

(3) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1939 and which were held for a period of not more than eighteen months (such basis and holding period having been computed in accordance with the provisions of Section 118 of the Internal Revenue Code) was $222,471.90 more than their selling price.

(4) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1939 and which were held for a period of more than eighteen

532 months (such basis and holding period having been computed in accordance with the provisions of Section 118 of the Internal Revenue Code) was $222,078.13 more than their selling price.

(5) The sum of $424,437.54 set forth in paragraph 5. (g) (1) hereof, was treated by the petitioner, in its return for 1939, as an addition to the cost of goods sold.

(h) (1) The facts and circumstances hereunder are similar to those alleged in paragraphs 5. (c) (1), 5. (c) (2), 5. (c) (3), 5. (c) (4), and 5. (c) (5) hereof.

533 (i) (1) The facts and circumstances hereunder are similar to those alleged in paragraphs 5. (d) (1), 5. (d) (2), 5. (d) (3), and 5. (d) (4) hereof.

(j) (1) The facts and circumstances hereunder are similar to those alleged in paragraphs 5. (e) (1), 5. (e) (2), 5. (e) (3), and 5. (e) (4) hereof.

(k) (1) In the 1940 return of the petitioner the sum of $680,587.39 representing net profit in 1940, from the purchase and sale of corn futures contracts, was treated as a reduction of the cost of goods sold. This amount is the net profit realized during 1940 from the purchase and sale
534 of corn futures contracts under facts and circumstances similar to those alleged in paragraphs 5. (a) (2), 5. (a) (3), 5. (a) (4), 5. (a) (5), 5. (a) (11), 5. (a) (12), and 5. (a) (13) hereof.

(2) The cost of the corn futures contracts purchased by the petitioner, which contracts were sold during 1940 and which were held for a period of not more than eighteen months (such cost and holding period having been computed without the application of the provisions of Section 118 of the Internal Revenue Code) was $680,587.39 less than their selling price.

(3) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1940 and which were held for a period of not more than eighteen months (such basis and holding period having been computed in accordance with the provisions of Section 118 of the Internal Revenue Code) was $62,328.10 less than their selling price. 535

(4) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1940 and which were held for a period of more than eighteen months (such basis and holding period having been computed in accordance with the provisions of Section 118 of the Internal Revenue Code) was $202,862.60 more than their selling price. 536

(5) The sum of $680,587.39 set forth in paragraph 5. (k) (1) hereof was treated by the petitioner in its return for 1940, as a reduction of the cost of goods sold.

(l) (1) In the 1941 return of the petitioner the sum of $180,056.23 representing net loss in 1941, from the purchase and sale of corn futures contracts was treated as a reduction of the cost of goods sold. This amount is the net loss realized during 1941 from the purchase and sale of corn futures contracts under facts and circumstances similar to those alleged in paragraphs 5. (a) (2), 5. (a) (3), 5. (a) (4), 5. (a) (5), 5. (a) (11), 5. (a) (12), and 5. (a) (13) hereof. 537

(2) The cost of the corn futures contracts purchased by the petitioner, which contracts were sold during 1941 and which were held for a period of not more than eighteen months (such cost and holding period having been computed without the application of the provisions of Section 118 of the Internal Revenue Code) was $180,056.23 less than their selling price.

538 (3) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1941 and which were held for a period of not more than eighteen months (such basis and holding period having been computed in accordance with the provisions of Section 118 of the Internal Revenue Code) was $29,034.37 less than their selling price.

(4) The basis of the corn futures contracts purchased by the petitioner, which contracts were sold during 1941 and which were held for a period of more than eighteen months (such basis and holding period having been com-
539 puted in accordance with the provisions of Section 118 of the Internal Revenue Code) was $61,818.68 less than their selling price.

(5) The sum of $180,056.23 set forth in paragraph 5. (l) (1) hereof, was treated by the petitioner in its return for 1941, as a reduction of the cost of goods sold.

WHEREFORE, the petitioner prays that this Court may hear the proceeding and grant the relief herein requested, together with any and all further relief that the Court may deem just and proper.

540

CORN PRODUCTS REFINING COMPANY,
By: H. CALLENDER
H. Callender, Treasurer
Petitioner,
17 Battery Place,
New York 4, N. Y.

(Verified March 7, 1949.)

EXHIBIT A, ANNEXED TO PETITION.

541

Form 1279 (Rev. Mar. 1946) SN-1T-7

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
New York 7, New York

Office of
Internal Revenue Agent in Charge
2nd New York Division
90 Church Street—Room 1120

Dec. 14, 1948 542

Corn Products Refining Company
17 Battery Place
New York 4, New York

Sirs:

You are advised that the determination of your excess profits tax liability for the taxable year ended December 31, 1942 discloses a deficiency of $1,520,519.39; that the determination of your declared value excess-profits tax liability for the year mentioned discloses a deficiency of $14,487.94; and that the determination of your income tax liability for the year mentioned discloses an overassessment of $242,494.37, as shown in the statement attached. 543

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are re-

544 quested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Room 1120, 90 Church Street, New York 7, New York, for the attention of NSM-90D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

545 GEO. J. SCHOENEMAN,
Commissioner,

By (Signed) C. R. KRIGBAUM
Internal Revenue Agent in Charge.

Enclosures:
Statement
Form of waiver and acceptance
Form of claim
MRF:mam

546 STATEMENT

CORN PRODUCTS REFINING COMPANY
17 Battery Place
New York 4, New York

Tax Liability for the Taxable Year Ended December 31, 1942

	Liability	Assessed	Overassessment	Deficiency
Income Tax	$ 5,712,422.98	$5,954,917.35	$242,494.37	
Declared value excess-profits tax	$ 14,487.94	None		$ 14,487.94
Excess Profits tax	$11,289,266.61	$9,768,747.22		$1,520,519.39

Exhibit A, Annexed to Petition.

In making this determination of your tax liability, careful consideration has been given to the reports of examination dated May 29, 1947 and April 29, 1948; and to your protest dated July 27, 1948. 547

The overassessment shown herein will be made the subject of a certificate of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 322 (a) of the Internal Revenue Code, provided that you fully protect yourself against the running of the statute of limitations with respect to the apparent overassessment referred to in this letter, by filing with the collector of internal revenue for your district, a claim for refund on Form 843, a copy of which is enclosed, the basis of which may be as set forth herein. 548

A copy of this letter and statement has been mailed to your representative, Mr. Milton M. Bernard, 10 East 40th Street, New York 16, New York, in accordance with the authority contained in the power of attorney executed by you.

Schedule 1

ADJUSTMENTS TO NET INCOME

Net income for declared value excess-profits tax computation as disclosed by return		$27,507,041.81
Unallowable deductions and additional income:		
(a) Excessive depreciation—machinery	$334,088.93	
(b) Pension and profit-sharing payments	168,616.26	
(c) Reserve for dextrose expense	137,529.70	
(d) Hummel and Downing pensions	19,504.68	

549

Exhibit A, Annexed to Petition.

550	(e) Development and experimental costs	114,105.57	
	(f) Loss on sale of machinery	469,825.09	
	(g) Patent costs	32,300.00	
	(h) Foreign dividend from Russell and Company	5,200.00	
	(i) Bad debt	850.91	
	(j) Foreign exchange loss	2,037.00	
	(k) Condemnation expenses	250.00	
	(l) Brazilian dividends	24,954.72	1,309,261.86
	Total		$28,816,303.67
551	Nontaxable income and additional deductions:		
	(m) Domestic dividend from Russell and Company	$ 4,160.00	
	(n) Patent depreciation	2,210.36	
	(o) Depreciation on buildings	9,972.11	
	(p) Interest on United States Treasury notes	8,389.98	
	(q) Interest on bonds of local housing authorities	10,148.14	
552	(r) Interest on defaulted bonds	43,591.87	
	(s) Salaries	38,139.84	
	(t) War loss	253.54	
	(u) Renegotiation adjustment	440,000.00	
	(v) Interest on New York, New Haven & Hartford bonds	6,784.42	
	(w) Interest on United States Treasury bonds	2,849.70	566,499.96
	Net income for declared value excess-profits tax computation, as adjusted		$28,249,803.71

Exhibit A, Annexed to Petition.

Schedule 1A

553

EXPLANATION OF ADJUSTMENTS

(a) Deduction claimed for accelerated depreciation of machinery is held to be excessive in the amount of $334,088.93, as follows:

Plant	Claimed	Allowed	Excess Disallowed
Argo	$224,278.11	$ 59,807.51	$164,470.60
Pekin	151,066.67	40,284.46	110,782.21
Kansas City	80,231.07	21,394.95	58,836.12
Totals	$455,575.85	$121,486.92	$334,088.93

554

(b) It is determined that the amounts paid to, or on behalf of, employees of your subsidiary companies do not constitute expenses deductible by you under Section 23 (a) (1) (A) of the Internal Revenue Code, since that section limits deductions to those paid or incurred by *the taxpayer* in carrying on a trade or business.

(c) It is held that the deduction claimed in the amount of $137,529.70 in respect of the addition to the reserve for advertising of dextrose does not constitute an allowable deduction under any of the provisions of Section 23 of the Internal Revenue Code.

555

(d) It is held that the deduction claimed in the amount of $19,504.68 in respect of pensions paid to the employees of the Hummel and Downing Corporation is not an allowable deduction under the provisions of the Internal Revenue Code.

(e) Development and experimental costs in the amount of $114,105.57 are held to represent expenses incurred in prior years and are, therefore, unallowable as current deductions.

556 (f) Deduction claimed for loss on sale of Edgewater plant machinery has been disallowed to the extent of $469,825.09, the details of which have been furnished you heretofore.

(g) Patent costs in the amount of $32,300.00 are held to represent capital expenditures and are, therefore, unallowable as current deductions.

(h) Dividend of $5,200.00 received in the taxable year from Russell and Company is held to be includible in full in taxable income as dividends received from foreign corporations (see contra adjustment (m), infra).

557 (i) It is held that the bad debt of $850.91 due from the Schuler Chocolate Company is not deductible under the provisions of Section 23 (k) of the Internal Revenue Code for the reason that the debt did not become worthless within the taxable year.

(j) It is held that loss claimed on foreign exchange by reason of the depreciation in value of Argentine deposits does not constitute a deductible loss within the purview of the Internal Revenue Code.

(k) It is held that expenditures incurred in connection
558 with the condemnation proceedings of the Edgewater plant constitute reductions in the proceeds of the sale of such property and, as such, do not represent allowable deductions under any of the provisions of Section 23 of the Internal Revenue Code.

(l) Brazilian dividends in the amount of $101,448.93, declared on December 5, 1940, are held to represent taxable income in the current year to the extent of $24,954.72.

(m) The amount of $4,160.00 reported as a domestic dividend from Russell and Company is excluded from income by reason of adjustment (h), supra.

Exhibit A, Annexed to Petition.

(n) and (o) Deductions claimed for depreciation of patents and of buildings are increased by $2,210.36 and $9,972.11, respectively, the details of which have been furnished you heretofore. 559

(p) and (q) Interest on United States Treasury notes and on bonds of local housing authorities reported in the amounts of $8,389.98 and $10,148.14, respectively, are held to be excludible from taxable income.

(r) The amount of $43,591.87 reported as interest on defaulted bonds of the following corporations is held to represent a return of capital: 560

Corporation	Amount
New Orleans, Texas and Mexico, Inc.	$ 7,592.50
Missouri, Pacific Railway	15,000.00
New York, New Haven and Hartford Railroad Company	20,999.37
Total	$43,591.87

(s) Deduction for salaries is increased by $38,139.84 for payments made to employees not claimed on return.

(t) A deduction is allowed in the amount of $253.54, representing war loss on the account receivable of George Wehry and Company. 561

(u) Your income is reduced by $440,000.00 representing renegotiation adjustment under Section 3806 of the Internal Revenue Code.

(v) The amount of $6,784.42 reported as interest on bonds of the New York, New Haven and Hartford Railroad Company is held to be properly reportable in the taxable year 1941 and to be excludible, therefore, from taxable income in the current taxable year.

Exhibit A, Annexed to Petition.

562 (w) Interest on United States Treasury bonds issued prior to March 1, 1941 is held to be excludible from taxable income.

Credit for income taxes paid to a foreign country has been decreased from $111,123.07 to $110,540.58, computed in accordance with the provisions of Sections 31 and 131 of the Internal Revenue Code.

Schedule 2

563 COMPUTATION OF TAX

INTERNAL REVENUE CODE AS AMENDED

DECLARED VALUE EXCESS-PROFITS TAX

Net income for declared value excess-profits tax computation, as adjusted		$28,249,803.71
Less: 10% of 270,000,000.00, value of capital stock as shown on your capital stock tax return for year ended June 30, 1942	$27,000,000.00	
564 Dividends received credit (85% of $1,212,105.27)	1,030,289.48	28,030,289.48
Net income subject to declared value excess-profits tax		$ 219,514.23
Declared value excess-profits tax, 6.6% of $219,514.23		$ 14,487.94

Exhibit A, Annexed to Petition.

Correct declared value excess-profits tax liability	$	14,487.94
Declared value excess-profits tax assessed: Original, Account No. 430004		None
Deficiency of declared value excess-profits tax	$	14,487.94

565

COMPUTATION OF TAX

INTERNAL REVENUE CODE AS AMENDED

INCOME TAX

566

Normal Tax:

Net income for declared value excess-profits tax computation as adjusted (Schedule 1)		$28,249,803.71
Add: Interest on obligations of certain instrumentalities of the United States issued prior to March 1, 1941		4,171.20
		567
Total		$28,253,974.91
Less: Declared value excess-profits tax		14,487.94
Net income		$28,239,486.97
Less: Interest on certain obligations of the United States and its instrumentalities issued prior to March 1, 1941		4,171.20
Adjusted net income		$28,235,315.77

Exhibit A, Annexed to Petition.

568

Less: Income subject to excess profits tax (Schedule 5)	$12,651,155.86		
Dividends received credit (85% of $1,212,105.27)	1,030,289.48	13,681,445.34	
Normal-tax net income			$14,553,870.43
Normal tax, 24% of $14,553,870.43			$ 3,492,928.90

569

Surtax:

Net income, supra			$28,239,486.97
Less: Income subject to excess profits tax (Schedule 5)	$12,651,155.86		
Dividends received credit (85% of $1,206,605.27)	1,025,614.48	13,676,770.34	
Surtax net income			$14,562,716.63
Surtax, 16% of $14,562,716.63			$ 2,330,034.66

570

Normal tax, supra			3,492,928.90
Total income tax			$ 5,822,963.56
Less: Credit for income taxes paid to a foreign country			110,540.58
Correct income tax liability			$ 5,712,422.98
Income tax assessed:			
Original, Account No. 430004			5,954,917.35
Overassessment of income tax			$ 242,494.37

Exhibit A, Annexed to Petition.

Schedule 3 571

ADJUSTMENTS TO EXCESS PROFITS NET INCOME

Excess profits net income computed under income credit method, as disclosed by return		$26,290,469.61
Additions:		
(a) Income adjustments per Schedule 1	$742,761.90	
(b) Dividends received credit adjustment 572	4,160.00	746,921.90
Total		$27,037,391.51
Deductions:		
(c) Declared value excess-profits tax		14,487.94
Excess profits net income computed under income credit method, as adjusted 573		$27,022,903.57

Exhibit A, Annexed to Petition.

574 Schedule 3A

EXPLANATION OF ADJUSTMENTS

(a) These adjustments are explained in Schedule 1A, supra.

(b) Dividends received credit adjustment has been decreased from $[illegible]16,265.27 to $[illegible]212,105.27 by reason of the elimination therefrom of dividend in the amount of $4,160.00 received from Russell and Company and erroneously reported as dividend received from domestic corporation. See explanation of adjustments (h) and (m),
575 Schedule 1A, supra.

(c) Deduction is allowed for declared value excess-profits tax as determined in Schedule 2, supra.

Credit for income taxes paid to a foreign country has been increased from $13,042.52 to $122,084.73, computed in accordance with the provisions of Sections 131 and 729 of the Internal Revenue Code.

Excess profits credit based on income has been increased from $12,327,211.54 to $12,511,744.23, the details of which have been furnished you heretofore.

576 Unused excess profits credit adjustment has been decreased from $2,649,602.80 to $1,855,003.48, computed as follows:

Year 1940		
Excess profits credit based on income, as determined	$12,504,488.97	
Excess profits net income, as determined	11,845,792.33	
Carryover of unused excess profits credit to the taxable year 1942		$ 658,696.64

Exhibit A, Annexed to Petition.

577

Year 1941		
Excess profits credit based on income as determined	$12,504,488.97	
Excess profits net income, as determined	11,308,182.13	
Carryover of unused excess profits credit to the taxable year 1942		1,196,306.84
Total unused excess profits credit adjustment for the taxable year 1942		$ 1,855,003.48

578

579

Exhibit A, Annexed to Petition.

580 Schedule 4

COMPUTATION OF ADJUSTMENT DUE TO APPLICATION OF SECTION 734

Net income for the taxable year 1939 as disclosed by report of examination dated May 31, 1947		$14,499,223.18
Deduct:		
581 Declared value excess-profits tax liability	$ None	
Interest on United States obligations	5,275.29	5,275.29
Adjusted Net Income		$14,493,947.89
Tentative tax at 19%		$ 2,753,850.10
Less: 14.025% of domestic dividends	$191,549.70	
2.5% of dividends paid credit	232,622.27	424,171.97
582 Normal tax		$ 2,329,678.13
Less: Foreign tax credit		235,958.46
Income tax liability		$ 2,093,719.67
Income tax previously assessed		2,072,269.61
Increase in income tax		$ 21,450.06
Interest from due date of filing return to March 15, 1943		3,861.01
Increase in income tax and interest		$ 25,311.07

Exhibit A, Annexed to Petition.

Schedule 5 583

COMPUTATION OF EXCESS PROFITS TAX

INTERNAL REVENUE CODE AS AMENDED

Excess profits net income computed under income credit method as adjusted (Schedule 3)		$27,022,903.57
Less: Specific exemption	$ 5,000.00	
Excess profits credit based on income, as adjusted 584	12,511,744.23	
Unused excess profits credit adjustment, as revised	1,855,003.48	14,371,747.71
Adjusted excess profits net income		$12,651,155.86
Excess profits tax imposed, 90% of $12,651,155.86		$11,386,040.27
Less: Credit for income taxes paid to a foreign country 585		122,084.73
Excess profits tax after foreign tax credit		$11,263,955.54
Amount due to application of section 734 (Schedule 4)		25,311.07
Correct excess profits tax liability		$11,289,266.61

Exhibit A, Annexed to Petition.

586 Excess profits tax assessed:

Original, Account No. 400901	$10,164,747.22	
Less: Credit previously allowed under section 3806(b)	396,000.00	9,768,747.22
Deficiency of excess profits tax		$ 1,520,519.39

CREDIT FOR POST-WAR REFUND OF EXCESS PROFITS TAX

587 Excess profits tax imposed, supra		$11,386,040.27
Credit allowable under section 780(a) of the Internal Revenue Code (10% of $11,386,040.27)		$ 1,138,604.03

Limitation under section 781(d):

Excess profits tax after foreign tax credit, supra		$11,263,955.54
Less: 588 Excess profits tax payable if rate were 81%:		
Tax at 81% rate (81% of $12,651,155.86)	$10,247,436.25	
Less: Credit for income taxes paid to a foreign country	120,460.31	10,126,975.94
Post-war credit allowable		$ 1,136,979.60

EXHIBIT B, ANNEXED TO PETITION.

589

COMPUTATION OF ADJUSTMENT OF ABNORMAL DEDUCTIONS UNDER SECTION 711(b)(1)(J)(ii) OF THE INTERNAL REVENUE CODE

"OTHER DEDUCTIONS AUTHORIZED BY LAW" FROM THE PURCHASE AND SALE OF CORN FUTURES CONTRACTS

	1936	1937	1938	1939
1932	$ 27,943.75	$	$	$
1933	*27,531.25*	*27,531.25*		
1934	3,450.00	3,450.00	3,450.00	
1935	*56,768.75*	*56,768.75*	*56,768.75*	*56,768.75*
1936		165,532.27	165,532.27	165,532.27
1937			*590,339.35*	*590,339.35*
1938				815,462.57
Total for four years	*52,906.25*	*84,682.27*	*478,125.83*	332,886.74
Average for four years	*13,226.56*	21,170.57	*119,531.46*	83,471.69
Actual Deductions	165,532.27	*590,339.35*	815,462.57	424,437.54
125% of Average	*16,533.20*	26,463.21	*149,414.33*	104,339.61
(A) Abnormal Deduction	165,532.27	—	815,462.57	320,097.93
Actual Deductions	165,532.27	*590,339.35*	815,462.57	424,437.54
Deductions for 1940	*680,587.39*	*680,587.39*	*680,587.39*	*680,587.39*
(B) Maximum Allowance—1940	165,532.27	—	815,462.57	424,437.54
1940—Lower of (A) or (B)	165,532.27		815,462.57	320,097.93
Actual Deductions	165,532.27	*590,339.35*	815,462.57	424,437.54
Deductions for 1941	*180,056.23*	*180,056.23*	*180,056.23*	*180,056.23*
(B) Maximum Allowance—1941	165,532.27	—	815,462.57	424,437.54
1941—Lower of (A) or (B)	165,532.27	—	815,462.57	320,097.93
Actual Deductions	165,532.27	*590,339.35*	815,462.57	424,437.54
Deductions for 1942	109,969.38	109,969.38	109,969.38	109,969.38
(B) Maximum Allowance—1942	55,562.89	—	705,493.19	314,468.16
1942—Lower of (A) or (B)	$ 55,562.89	$ —	$705,493.19	$314,468.16

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Amount of deduction to be disallowed in determining:

(1) Excess Profits Credit Based on Income for 1942 — $314,468.16

(2) Unused Excess Profits Credit Adjustment for 1942 from 1941 — 314,468.16

(3) Unused Excess Profits Credit Adjustment for 1942 from 1940 — 314,468.16

[Figures in italics were red in original.]

Answer.

592

[SAME TITLE.]

Comes now the Commissioner of Internal Revenue, through his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petititon.

593

3. Admits that the taxes in controversy are for the calendar year 1942, representing deficiencies claimed by the Commissioner of Internal Revenue of excess profits tax in the sum of $1,520,519.39 and declared value excess-profits tax in the sum of $14,487.94. Denies the remaining allegations contained in paragraph 3 of the petition.

4. (a) to (l), incl. Denies the allegations of error contained in subparagraphs (a) to (l), inclusive, of paragraph 4 of the petition.

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5. (a) (1). For lack of information upon which to form a belief, denies the allegations contained in subparagraph (a) (1) of paragraph 5 of the petition.

5. (a) (2) to (5), incl. Denies the allegations contained in subparagraphs (a) (2) to (5), inclusive, of paragraph 5 of the petition.

5. (a) (6) to (10), incl. For lack of information upon which to form a belief, denies the allegations contained in subparagraphs (a) (6) to (10), inclusive, of paragraph 5 of the petition.

5. (a) (11) and (12). Denies the allegations contained in subparagraphs (a) (11) and (12) of paragraph 5 of the petition for the reason that the matter contained therein is argumentative. 595

5. (a) (13). Denies the allegations contained in subparagraph (a) (13) of paragraph 5 of the petition.

5. (b) (1) to (6), incl. For lack of information upon which to form a belief, denies the allegations contained in subparagraphs (b) (1) to (6), inclusive, of paragraph 5 of the petition.

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5. (c) (1) and (2). For lack of information upon which to form a belief, denies the allegations contained in subparagraphs (c) (1) and (2) of paragraph 5 of the petition.

5. (c) (3) to (5), incl. Denies the allegations contained in subparagraphs (c) (3) to (5), inclusive, of paragraph 5 of the petition.

5. (d) (1) to (4), incl. Denies the allegations contained in subparagraphs (d) (1) to (4), inclusive, of paragraph 5 of the petition. 597

5. (e) (1) to (4), incl. Denies the allegations contained in subparagraphs (e) (1) to (4), inclusive, of paragraph 5 of the petition.

5. (f) (1). Denies the allegations contained in subparagraph (f) (1) of paragraph 5 of the petition.

5. (g) (1) to (5), incl. For lack of information upon which to form a belief, denies the allegations contained in subparagraphs (g) (1) to (5), inclusive, of paragraph 5 of the petition.

Answer.

598 5. (h) (1), (i) (1) and (j) (1). Denies the allegations contained in subparagraphs (h) (1), (i) (1), and (j) (1) of paragraph 5 of the petition.

5. (k) (1) to (5), incl. For lack of information upon which to form a belief, denies the allegations contained in subparagraphs (k) (1) to (5), inclusive, of paragraph 5 of the petition.

5. (l) (1) to (5), incl. For lack of information upon which to form a belief, denies the allegations contained in subparagraphs (l) (1) to (5), inclusive, of paragraph 5
599 of the petition.

Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the determination of the Commissioner be approved and appeal denied.

(Signed) CHARLES OLIPHANT
HDT

600 CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue.

OF COUNSEL.

R. P. HERTZOG,
Division Counsel.
WALT MANDRY,
Special Attorney,
Bureau of Internal Revenue.

[SAME TITLE.]

Jay O. Kramer, Esq., and *Samuel A. McCain, Esq.*, for the petitioner.

Walt Vandry, Esq., for the respondent.

OPPER, *Judge:* Respondent determined deficiencies for the year 1942 in excess profits tax and declared value excess profits tax of $1,520,519.39 and $14,487.94, respectively. 602 Petitioner does not contest certain adjustments. The issues remaining are:

1 (a). Whether the profits and losses sustained by petitioner in the years 1939 to 1942, inclusive, on the purchase and sale of corn futures constituted capital gains and losses under section 117, and thus a proper elimination from base period losses for excess profits tax purposes.

1 (b). Whether losses sustained by petitioner from transactions in corn futures are subject to the wash sales 603 provisions of section 118.

1 (c). If the answer to 1 (a) is in the negative, whether the net loss on corn futures transactions sustained by petitioner in the base period year 1939 constituted an abnormal deduction under section 711 (b) (1) (J) (ii).

2. Whether dividends declared by foreign corporations payable to petitioner in foreign currency in the base period year 1939 were so blocked by foreign exchange restrictions as not to constitute taxable income in that year.

604 3. Whether sums paid out as "salaries" and included as part of cost of sales are deductible, although in a later year it was discovered that the amounts had been embezzled and reimbursement from insurance was subsequently received.

4. Whether, in computing petitioner's unused excess profits credit carry-over from 1941 to 1942, the provisions of Section 721 apply so as to exclude 1941 abnormal income from excess profits net income of that year, even though petitioner had no excess profits tax liability for 1941.

605 Some of the facts have been stipulated. The record in *Corn Products Refining Co.*, 16 T. C. 395, has been incorporated by agreement as evidence in this proceeding.

Findings of Fact.

The stipulated facts in this proceeding, and the findings of fact in *Corn Products Refining Co.*, 16 T. C. 395, are hereby found accordingly.

Petitioner is a New Jersey corporation with its principal office in New York City. It filed its 1942 return with
606 the collector of internal revenue for the second district of New York.

Issue 1.

Petitioner is engaged in the manufacture and sale of corn products, including starches, sugar, syrups, oils and feeds. The principal product obtained by petitioner from raw corn is starch. Cerelose, which is one of petitioner's major products, is a refined sugar derived from starch which competes with cane and beet sugar. Petitioner's plants have a daily grind capacity of 170,000 bushels, and

its raw corn storage capacity of 2,303,000 bushels enables it to keep on hand somewhat less than a three-weeks' supply. In the years 1938 to 1942, inclusive, petitioner made purchases of raw corn aggregating 35,650,773, 36,806,869, 37,222,409, 54,079,173, and 60,761,513 bushels, respectively. 607

Petitioner's sales policy has been to contract for shipments within 30 days at a specified tentative price, with the understanding that the final price shall be the contract price or market price at date of delivery, whichever is lower. When a customer refuses to accept delivery of cerelose or feed, it has been petitioner's practice to cancel the unexecuted portion of the order.

Petitioner's general sales policy of contracting for 30-day shipments has had exceptions and variations, including the following: In 1927, petitioner entered into a contract with the Huron Milling Company, and in 1932 it entered into a contract with the Keever Starch Company, under both of which contracts petitioner was required to manufacture and deliver large quantities of starch for a period of 15 years, the price in both contracts being dependent upon a number of factors, including the price of corn and labor. The Huron contract was modified on June 1, 1942, and extended for an additional 10 years. In May 1939 petitioner entered into a contract with Eastern Milling Co., under which petitioner was required to deliver quantities of feed each month until May 1940, with a guarantee as to price. On January 15, 1940, petitioner invited all buyers to submit on or prior to January 20, orders for cerelose to be delivered as late as June 30, 1940, buyers being guaranteed the lower of the January 15 price or the price in effect at date of delivery, and being allowed to cancel all or part of their orders. Petitioner received many orders in response to that invitation and its sales of cerelose at that time approximated 2,000,000 bags. Members of the canning industry on the Pacific Coast have been permitted to call on petitioner for cerelose for de 608 609

610 livery in more than 30 days, with price guarantees and allowance for cancellations.

For a number of years it has been petitioner's custom to purchase and sell corn futures contracts through members of a recognized Commodity Exchange. A corn future is a contract calling for the delivery at a stated time, within eleven months or less, of 5,000 bushels of corn or some multiple thereof, of a stated quality, at a stated price. Petitioner engaged in futures transactions as a part of its corn buying program and as the most economical method of obtaining an adequate supply of raw
611 corn in view of its limited storage facilities and the expense of increasing those facilities sufficiently to take care of its needs. Purchases of futures were made when the price of corn was advantageously low. Petitioner took delivery of corn on some contracts, but it usually sold most of its futures in early summer if it then appeared that there would be no shortage of corn and no great danger of increased prices. If the crop was poor or there was danger of a price increase it sold its futures gradually as it bought corn for grinding. Petitioner would begin to acquire additional futures contracts at harvest time each year.

612 The corn futures contracts were not subject to depreciation and were not included in inventory. Petitioner's raw corn inventory account was affected only when petitioner took delivery under a futures contract. Profits or losses on futures were shown in a "Corn Miscellaneous" account. The net gain or loss for each year was debited or credited to cost of sales, and treated as a reduction or addition to cost of goods sold.

During late 1939 and early 1940 petitioner maintained a long position in corn futures contracts of from 7,000,000 to 8,000,000 bushels. In 1940 the Commodity Exchange Authority formally charged petitioner with speculating in grain on the ground that it had a long position in excess

by more than 2,000,000 bushels of the amount it required for hedging. At a hearing petitioner took the position that its futures were not in excess of its needs and that the contracts it held were necessary to cover the products which it expected to market over a period of 15 to 18 months. In demonstrating its needs petitioner submitted evidence as to its unfilled orders, its sales commitments, its contracts with the Huron Milling Company and the Keever Starch Company, and the estimated number of bushels of corn that would be required to meet such commitments. Petitioner relied also upon weekly and daily reports which it had filed with the Authority giving information as to its position with respect to grain futures. Petitioner had included in those reports, among other matters, detailed information as to its transactions in grain, and its purchase and sales commitments for grain, or grain products, and it stated in such reports that its futures were classifiable in character as hedging, rather than as speculative transactions. Petitioner was upheld in its contentions in the proceeding before the Commodity Exchange Authority, and the action was dismissed. 613 614

The parties have stipulated the net gain or loss from the purchase and sale of corn futures in each year from 1932 to 1942, inclusive, the monthly purchases of bushels of raw corn by petitioner from January 1938, to December 1942, the monthly purchases and sales of corn futures during the same period including the number of contracts and number of bushels, the monthly purchases of corn futures from October 1937 to December 1942 under which delivery was taken at maturity dates, the monthly sales of corn futures from January 1938 through December 1942, including the number of contracts and number of bushels, and the stock on hand and unfilled orders for cerelose and for feed at the beginning of each month during the year 1942. 615

The parties have stipulated for each of the years 1939

616 and 1942 the separate gain or loss to petitioner resulting from the sale of corn futures held for not more than six months and from the sale of corn futures held for more than six months, as computed both with and without the application of section 118 of the Internal Revenue Code.

During 1942 petitioner had gross sales of more than $131,000,000 and gross profits from sales of more than $35,000,000. Its net loss from the purchase and sale of corn futures was $109,969.38. At the beginning and end of that year its inventory (including raw corn and processed products valued at cost or market, whichever was lower) was approximately $7,650,000 and $5,900,000, re-
617 spectively.

There was no significant change in petitioner's method of doing business between December 31, 1940, and December 31, 1942.

Petitioner's purchases of corn futures did not constitute speculative transactions for profit, but were consummated in order to obtain business protection and to insure the profitable conduct of its business.

Issue 2.

618 During all periods material to this proceeding the books and records of petitioner and its subsidiaries were kept on an accrual basis.

During 1939 Maizena, Brazil, S. A., a Brazilian corporation, hereinafter called Maizena, and Refinacoes De Milho, Brazil, S. A., a New Jersey corporation, hereinafter called Refinacoes, were petitioner's wholly-owned subsidiaries. In that year Refinacoes owed Maizena money for commissions. On the books of Maizena the commissions were credited to profit and loss, and debited to its accounts receivable account for Refinacoes. Maizena paid taxes to Brazil upon the commissions.

In December 1938 Maizena declared a dividend, payable January 13, 1939, and set up on its books an account payable to petitioner in the amount of 2,175,000 Brazilian milreis. In June 1939 petitioner debited an accounts receivable account known as blocked account, Maizena, Brazil, S. A., and it credited blocked income which was a deferred credit income account. Petitioner used a rate of exchange of 5.95 cents per milrei. The Internal Revenue Bulletin stated that the rates of exchange acceptable as the prevailing current or market rates were 5.86 cents per milrei as of December 30, 1938, and 6.058 cents per milrei as of December 30, 1939. There was also an unofficial rate of exchange in Brazil. 619 620

Petitioner was interested at that time in selling milreis for dollars to foreign exchange dealers in New York, if favorable rates were obtainable. There were restrictions in Brazil in 1939 with respect to transmitting funds out of that country. The record does not disclose the nature or extent of such restrictions.

In 1939 petitioner received a portion of the above dividend in the amount of $4,862.31, which was the dollar equivalent of 100,649.9 milreis. That payment was made by draft, payable in petitioner's favor, and drawn by the Bank of Brazil upon the Guaranty Trust Co. The record does not disclose the circumstances under which such drafts were procured. Petitioner received the balance of the dividend in 1940. Upon receiving payment petitioner debited its cash and blocked income accounts, and credited income and its blocked account, Maizena, Brazil, S. A. 621

During 1939 petitioner was a major stockholder in several Italian companies, including S. A. Anticromos Dott Aldo Volpino-Milan, hereinafter called Anticromos, S. A. Ligure Industriale Commerciale-Genoa, hereinafter called Ligure, S. A. Prodotti del Mais-Milan, hereinafter called Prodotti, and Fabbriche Riunite Amido Glucosia Destrina-Milan, hereinafter called Fabbriche. Petitioner had

622 wholly-owned Italian subsidiaries, including Societe Finanziaria Agricola Italo-Americana-Milan, hereinafter called Finanziaria.

In May 1939 dividends in lire were declared by the above corporations and set up on their books as accounts payable to petitioner, as follows: Anticromos—142,920; Ligure—565,763; Prodotti—1,643,718; and Fabbriche—2,143,926 lire. In that year petitioner entered the above amounts on its books by debiting its accounts receivable maintained for the above corporations which were called blocked accounts, and by crediting its blocked income account, which was a deferred credit to income. Petitioner
623 used a rate of 5.2625 cents per lire which was the published rate of exchange on the date of declaration of dividends.

The dividends declared by Anticromos and Ligure were paid in the same year to petitioner's subsidiary, Finanziaria. Finanziaria credited petitioner's account and accrued interest which was also credited. An undisclosed portion of the dividends received by Finanziaria and an undisclosed portion of the dividends declared by Prodotti and Fabbrichi were transferred on undisclosed dates to Italian banks for petitioner's credit. The record does
624 not disclose when the Italian dividends which were declared in 1939 payable to petitioner, were received by the latter.

Petitioner was anxious at a reasonable price to realize dollars for its lire, and it was able in New York to sell to foreign exchange dealers some of the lire in its bank accounts at unofficial rates. In November and December 1939 petitioner converted the sums of 210,000 and 200,000 lire into dollars at an average rate of approximately $.021 per lira. The latter lire would come out of dividends declared in 1936, if treated on a first in, first out basis. The record does not disclose the nature or extent of the ex-

change restrictions in Italy on transmitting funds out of 625
that country.

Petitioner's consistent bookkeeping practice, in treating a foreign dividend payable to it and blocked by exchange restrictions, has been to record the dividend as a receivable at the prevailing rate of exchange with a credit to deferred income, and to treat the amount as income in the year of actual receipt in the United States. Petitioner has adhered to that procedure following an internal revenue agent's suggestions in connection with examinations of its returns for certain years prior to the period here involved.

Petitioner's 1939 tax return reported as income the por- 626
tion of the Maizena dividend received in that year. It did not report the remainder of the Maizena dividend or the dividends declared in that year by the Italian corporations. That method of reporting was in accordance with petitioner's practice, in 1939 and subsequent years, of reporting items of foreign income, blocked by exchange restrictions, at the time of actual receipt, and treating them as capital gain items with a cost basis of zero.

The dividends in controversy were not unqualifiedly subject to petitioner's demand in the year 1939. In 1939 there was no market for the unconverted Brazilian milreis 627
and the Italian lire here in controversy, and no one could form an opinion as to their values in that year.

ISSUE 3.

During 1942 petitioner paid out as "salaries" the gross sum of $37,620.44. The net amounts so paid were in fact embezzled by the paymaster and were not received by the employees designated on the checks as payees. The total sum of $37,620.44 was deducted in good faith as part of cost of sales. In addition, based upon the above "salaries," petitioner withheld and paid to the Treasury, as the em-

628 ployer's portion of Federal Old Age Benefit, the amount of $357.39, and as Federal Unemployment Insurance the amount of $676.55. The latter sums were deducted in good faith.

In 1948 petitioner discovered the embezzlements and made a claim for reimbursement from its surety under its policy of insurance which was in effect at all times. In 1949, under the terms of its policy, petitioner received from the surety reimbursement of the above sum of $37,620.44, without interest.

Respondent's notice of deficiency, mailed on December 14, 1948, did not disallow any of the above sums. At the
629 hearing, respondent claimed an additional deficiency based upon the disallowance of the amount of $37,620.44 as a deduction for 1942.

ISSUE 4.

Petitioner had no excess profits tax liability for 1941, and in so determining, respondent excluded from petitioner's excess profits net income for that year the sum of $436,945.36 as abnormal income under section 721 of the Internal Revenue Code. Respondent's computation of pe-
630 titioner's unused excess profits tax credit carry-over from 1941 to 1942 did not exclude from petitioner's excess profits net income for 1941 the said amount of $436,945.36.

OPINION. 631

I.

Issue 1 (a):

Although perhaps not conforming technically to the definition of a hedge,[1] it seems indisputable as our findings show that petitioner's practice of purchasing corn futures was an integral part of its manufacturing business. *Ben Grote*, 41 B. T. A. 247; see *Kenneth S. Battelle*, 47 B. T. A. 117, 127. It would hence be anomalous to view them as purely speculative transactions of a capital nature,[2] especially considering that this is "largely a factual question," *Kenneth S. Battelle, supra*, 125, and the burden here is on petitioner to show that it incorrectly treated the losses as ordinary on its original tax returns. Only by so doing can it succeed in maintaining its present position that losses in the base period were improperly employed to arrive at a smaller income than actually received. 632

Futures contracts need not be concurrent with spot transactions in order to be a hedge. G. C. M. 17322 (1936), XV-2, C. B., 151. In neither *Tennessee Egg Co.*, 47 B. T. A. 558, nor *Estate of Dorothy Makransky*, 5 T. C. 397, affirmed (C. A. 3), 154 F. 2d 59, were there future commitments against which the futures purchased could operate as an offset. In the former, petitioner's failure to 633

[1] "* * * to hedge, i.e., to insure themselves against loss by unfavorable changes in price at the time of actual delivery of what they have to sell or buy in their business; * * *." *United States* v. *New York Coffee & Sugar Exchange, Inc.*, 263 U. S. 611. See Patterson, "Hedging and Wagering on Produce Exchanges," (1931); 40 Yale L. J., 843, 846.

[2] "* * * For example, if a manufacturer or processor of raw material is short on inventory and makes sales of his finished products for forward delivery, the appropriate hedging transaction in that instance would be the purchase of raw material futures at or about the time he makes the sale." *Stewart Silk Corp.*, 9 T. C. 174, 178."

634 sustain its burden of proof is emphasized, and in the latter the venture in question was an isolated transaction and not a component of a regular practice of balancing transactions systematically conducted. Neither case is authority militating against our conclusion that petitioner's losses on its futures contracts were properly treated as ordinary losses. *Stewart Silk Corp.*, 9 T. C. 174, 179.

II.

ISSUE 1 (b).

635 Petitioner's alternative contention that Internal Revenue Code, section 118, forbade deduction of these losses as wash sales must be rejected on authority of *Corn Products Refining Co.*, 16 T. C. 395, a prior decision involving this same petitioner from which we see no reason to depart.

III.

ISSUE 1 (c).

636 That the future contracts gave rise to a separate class of losses, however, we think admits of little doubt. Although related to petitioner's cost of operations, they cannot be considered an inventory item, *Modesto Dry Yard, Inc.*, 14 T. C. 374, nor, since the grain itself was never acquired, a part of the cost of goods sold. See *Tennessee Egg Co., supra; Estate of Dorothy Makransky, supra; Modesto Dry Yard, Inc., supra.* Being losses on transactions comparable to hedges, they are strictly similar only to other hedge transactions. We conclude that, being greater than 125 per cent of previous items of the same character, the losses are subject to treatment under section 711 (b) (1) (J) (ii). *Green Bay Lumber Co.*, 3 T. C.

824; *Welch Grape Juice Co.*, 9 T. C. 786; *Mine and Smelter Supply Co.*, 10 T. C. 1179. 637

For the first time on brief, respondent seeks to invoke the provisions of section 711 (b) (1) (K). Assuming that the ordinary burden of disclosure rested upon petitioner in that state of the record, but see *Green Bay Lumber Co., supra; Wentworth Manufacturing Co.*, 6 T. C. 1201, it has in our view been adequately met. There is no apparent causal connection between the losses on futures and the gross income or deductions of petitioner's operations. And the abnormal losses do not seem to have been a consequence of a change in the manner and scope of petitioner's operations. *R. C. Harvey Co.*, 5 T. C. 431; *Laredo Bridge Co.*, 7 T. C. 17. 638

If there are more obscure connections between the contested losses and any of the enumerated aspects of petitioner's activities as described in section 711 (b) (1) (K), it was incumbent on respondent to give some adequate notice of his proposed position. A taxpayer cannot be expected to negative every possible element of some hypothetical defense. *Wentworth Manufacturing Co., supra.*

In this respect respondent's determination was erroneous.

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IV.

Issue 2.

On petitioner's claim that it understated its 1939 income by failing to report dividends received in Brazil and Italy, we conclude that the burden of proof which rested on petitioner has not been discharged. It is not sufficient for the dividends to have been received in foreign territory. They must have been convertible into American dollars before petitioner could be charged with them as income. *Foundation Co.*, 14 T. C. 1333. This was one of

640 the issues in the case and proof of convertibility was requisite under the circumstances. *International Mortgage & Investment Corp.*, 36 B. T. A. 187. In *Weil* v. *Commissioner* (C. A. 2), 150 F. 2d 950, the taxpayer had the burden of proving the absence of free convertibility, rather than as here, its presence, and failed to carry it. Petitioner's failure to sustain its burden in this respect is the basis for our conclusion contained in the findings that there was no market for the foreign exchange in dispute.

In fact, what evidence there is indicates that these payments were actually blocked by the respective exchange restrictions of the countries involved. The facts show
641 that except for a small portion actually converted in some manner not disclosed, and not here in controversy, the entire amount was credited to deferred income. This was stated to be petitioner's method of dealing with blocked funds: "If the foreign dividend payable to us was blocked by exchange restrictions our practice was to book the dividend as a receivable at the prevailing rate of exchange, offset by a credit to the deferred income, taking it into income in the year it was received." When the dividends were "received," that is, when they were exchanged into dollars and transferred to the United States—all of which
642 occurred subsequent to the year in issue—and not until then were they recorded as income. On this issue the deficiency is sustained.

V.

ISSUE 3.

We do not view the issue affirmatively raised by respondent as one directly involving the deductibility of an embezzlement loss. At the close of the taxable year in question, 1942, from all that was then known, petitioner correctly deducted the amounts in issue as compensation

for services. The fact that six years later it was discovered that these items had never been paid to the employees but had been misappropriated and that a year after that petitioner was able to collect from its insurer would, as in *E. B. Elliott Co.*, 45 B. T. A. 82, be pertinent facts for consideration if the year 1942 could be dealt with in reliance upon them. But as we have frequently reiterated, the *Elliott* rule no longer applies. *Standard-Tilton Milling Co.*, 3 T. C. 1026; *Taylor Instrument Companies*, 14 T. C. 388. 643

Only by reviewing the year in controversy in the light of facts discovered many years later can petitioner's position be attacked. This as we have said we are no longer in a position to do. *Schwabacher Hardware Co.*, 45 B. T. A. 699, was decided after *E. B. Elliott Co., supra*, and on its authority, and before *Standard-Tilton Milling Co., supra*. For that reason it has no application to these proceedings. And in *Samuel M. Felton*, 5 T. C. 256, the burden was not upon respondent, as it is here, but upon petitioner. Under the *Security Flour Mill*[3] rule, respondent has not even closely approximated the discharge of the burden which he is required to bear. On this issue, decision will be for petitioner. 644

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ISSUE 4.

The final question is controlled by *San Francisco Stevedoring Co.*, 8 T. C. 222, as petitioner concedes. It attacks the conclusion there reached and urges us to depart from it. This we are unwilling to do. On the authority of that case, the deficiency is sustained in this respect.

Decision will be entered under Rule 50.

Entered June 30, 1952.

[3] *Security Flour Mills v. Commissioner*, 321 U. S. 281.

646

Supplemental Opinion.

20 T. C. No. 68

[SAME TITLE.]

Docket No. 22074 Promulgated May 28, 1953.

Computation of amount of abnormality under section 711(b)(1)(J)(ii) on account of petitioner's corn futures transactions, in which it had net gains in some previous years and net losses in others, 647 *held* to require consideration only of annual net losses on such transactions.

Jay O. Kramer, Esq., Samuel A. McCain, Esq., for the petitioner.

Walt Mandry, Esq., for the respondent.

OPPER, *Judge*: This proceeding was originally decided by Memorandum Opinion entered June 30, 1952. Upon the recomputation under Rule 50, it became evident that an issue not previously perceived by either party remained to be disposed of. Leave was granted to reopen 648 the proceeding for the disposition of that question.

The issue is a narrow and technical problem as to the correct computation to be employed for excess profits tax purposes under section 711 (b) (1) (J). In our prior opinion we held that petitioner's losses from dealings in corn futures, being comparable to hedging, were a separate class of deduction and were accordingly entitled to be disregarded where they exceeded 125 per cent of the losses for the four previous years under subdivision (ii). It develops that the losses from hedging transactions were to some extent offset by gains from similar transactions and it is the proper employment of such figures in the

recomputation as to which the parties are now in disagreement. 649

In two of the four years prior to 1939, the only base period year which was in issue, there were in fact excesses of gains over losses. Respondent contends that only the other two years, where the net result of the hedging operations was a loss, should be given effect. Petitioner's approach is in the alternative, either that only the losses should be considered without regard to offsetting gains in any year, or that all four years should be included with the net gain years included as well as those showing a net loss. The submitted figures follow: 650

	Respondent's computation using only (net losses)	Petitioner's computation No. 1, using (net losses) and net gains	Petitioner's computation No. 2, using only (gross losses)
Base period year (1939)	($424,437.54)	($424,437.54)	($691,853.14)
4 previous taxable years:			
1935	0	56,768.75	(66,682.50)
1936	(165,532.27)	(165,532.27)	(248,063.52)
1937	0	590,339.35	(2,050.00)
1938	(815,462.57)	(815,462.57)	(864,606.32)
Total of four years	($980,994.84)	($333,886.74)	($1,181,402.34) 651
Annual average	(245,248.71)	(83,471.69)	(295,350.59)
125% of average	(306,560.89)	(104,339.61)	(369,188.24)
Excess of 1939 over 125% of average of 4 previous years	($117,876.65)	($320,097.93)[1]	($322,664.90)

While the parties agree that the question is novel, we think the principle adopted by respondent is correct. Starting with the base period year deduction it

[1] Because of the limitation imposed by section 711 (b) (1) (K) (iii), the claimed adjustment for computation of the 1942 excess profits credit was reduced to $314,468.16.

652 seems to us inescapable that $424,437.54 representing as it does the net loss rather than the larger figure of the gross loss without accounting for offsetting gains is necessarily the correct one. This proceeds in part from the provisions of section 711 (b) (1) (K), the purpose of which is to insure that abnormal deductions shall not be disallowed if they are connected with offsetting items of gross income. See *Frank H. Fleer Corporation*, 10 T. C. 191. In fact, we held here in the prior opinion that because no offsetting items of income were apparently involved, the provisions of subdivision (K) did not preclude treatment of the deduction as an abnormality.
653 It seems to us inconsistent now to suggest that anything but the net figure of the excess of losses over gains can be considered as the correct method of dealing with the loss deduction, bearing in mind the intimate interconnection between subdivisions (J) and (K). *Frank H. Fleer Corporation, supra*, 200.

Turning then to the provisions of 711 (b) (1) (J) (ii) itself,[2] it seems evident that the deductions for the four prior years, being referred to as a "class," are to be treated as coordinate with that for the base period year in question. It follows that these deductions also must
654 be confined to net losses, consisting of the excess of losses over gains.

Under the same provisions it would be anomalous to deal with the results of any of the prior years as "deductions" whereas in this case the net result in several years is not a deduction but a net gain which is in essence an item adding to petitioner's gross income. As to those years it necessarily follows that the loss is non-

---

[2] "(ii) If the class of deductions was normal for the taxpayer, but the deductions of such class were in excess of 125 per centum of the average amount of deductions of such class for the four previous taxable years, they shall be disallowed in an amount equal to such excess."

existent and must accordingly be represented by zero as 655
respondent has done.

We conclude that only the net loss years may be considered as giving rise to "deductions" but since the statute requires an average of the "four previous years," the years in which no net losses occurred must be included in computing the average.

Reviewed by the Court.

Decision will be entered under Rule 50.

(Seal)

656

Decision.

[SAME TITLE.]

Respondent having on June 9, 1953, filed a recomputation of tax for entry of decision as in accordance with Memorandum Findings of Fact and Opinion of the Court, entered June 30, 1952, and Supplemental Opinion of the Court, promulgated May 28, 1953, and petitioner having concurred therein, now, therefore, it is

657

ORDERED and DECIDED: That there are deficiencies in declared value excess-profits tax and excess profits tax for the taxable year 1942 in the amounts of $14,487.94 and $1,221,879.44, respectively.

(Signed) CLARENCE OPPER
Judge

ENTERED JUN 15, 1953

ENTER:

(Seal)

Stipulation of Facts.

658

[SAME TITLE.]

It is hereby stipulated by and between the parties hereto through their attorneys that the following facts may be taken to be true for the purposes of this proceeding without prejudice to the rights of either party to introduce other and further evidence not inconsistent herewith:

659

1. Petitioner is a corporation organized under the laws of the State of New Jersey on February 6, 1906, with its principal office at 17 Battery Place, New York 4, N. Y.

2. Its income tax return for the calendar year 1942 was filed with the Collector of Internal Revenue, Second District of New York.

3. The deficiency letter (a copy of which is annexed to the petition) was mailed to petitioner on December 14, 1948.

660

4. The taxes in controversy for the calendar year 1942 represent deficiencies claimed by respondent in excess profits tax in the sum of $1,520,519.39, and declared value excess profits tax in the sum of $14,487.94, as against a refund claimed by petitioner in Form 843 with the Bureau.

5. Petitioner is a nationally known corporation engaged in the manufacture and sale of corn products, including starches, syrups, oils, and other corn derivatives.

6. Its products are sold to subsidiaries, affiliated companies, and to outside customers. 661

7. It had been the custom of petitioner for a number of years prior to 1942 to purchase corn futures contracts. The net gain or net loss in each of the years from 1932 through 1942 from the purchase and sale of corn futures contracts was as follows:

Year	Net Gain (treated as a reduction of cost of goods sold)	Net Loss (treated as an addition to cost of goods sold)
1932	$	$ 27,943.75
1933	27,531.25	
1934		3,450.00
1935	56,768.75	
1936		165,532.27
1937	590,339.35	
1938		815,462.57
1939		424,437.54
1940	680,587.39	
1941	180,056.23	
1942		109,969.38

662

8. All corn futures contracts purchased and sold during 1938 to 1942 were purchased and sold through members of a recognized Commodity Exchange. 663

9. Such contracts were subject to the rules, regulations and customs of the Commodity Exchange where the trades were made.

10. During the year 1939 petitioner derived a net loss of $424,437.54 from the purchase and sale of corn futures contracts. See Paragraph 7 above and Exhibit 1-A attached hereto.

664 11. This loss of $424,437.54 was treated in petitioner's tax return for the year 1939 as an addition to "Cost of Goods Sold." In its tax returns for prior years the petitioner treated the gains or losses resulting from purchase and sale of corn futures contracts as a reduction of, or as an addition to, cost of sales.

12. During the year 1942 petitioner derived a net loss of $109,969.38 from the purchase and sale of corn futures contracts.

13. This loss of $109,969.38 was treated in petitioner's
665 tax return for the year 1942 as an addition to "Cost of Goods Sold." In its tax returns for prior years the petitioner treated the gains or losses resulting from purchase and sale of corn futures contracts as a reduction of, or as an addition to, cost of sales.

14. The cost of corn futures contracts purchased by petitioner, which contracts were sold during 1939, and which were held for a period of not more than six months, was $92,453.09 less than their selling price (computed without the application of Section 118 of the Internal Revenue Code).

666

15. The basis of the corn futures contracts purchased by petitioner, which contracts were sold during 1939, and which were held for a period of not more than six months, was $2,350.00 more than their selling price when their basis and holding period are computed in accordance with the provisions of Section 118 of the Internal Revenue Code; but nothing contained in this paragraph shall constitute a concession by respondent of the legal conclusions that the corn futures contracts in question were "capital assets" within the meaning of Section 117 of the Internal Revenue Code, or that Section 118 applies thereto. See Exhibit 1-A attached hereto.

16. The cost of corn futures contracts purchased by petitioner, which contracts were sold during 1942, and which were held for a period of not more than six months, was $197,598.13 more than their selling price (computed without the application of Section 118 of the Internal Revenue Code). 667

17. The basis of the corn futures contracts purchased by petitioner, which contracts were sold during 1942, and which were held for a period of not more than six months, was $606.25 less than their selling price when their basis and holding period are computed in accordance with the provisions of Section 118 of the Internal Revenue Code; but nothing contained in this paragraph shall constitute a concession by respondent of the legal conclusions that the corn futures contracts in question were "capital assets," within the meaning of Section 117 of the Internal Revenue Code, or that Section 118 applies thereto. See Exhibit 1-A attached hereto. 668

18. The basis of corn futures contracts purchased by petitioner, which contracts were sold during 1939, and which were held for a period of more than six months, was $516,890.63 more than their selling price when their basis and holding period are computed in accordance with the provisions of Section 117. 669

19. The basis of corn futures contracts purchased by petitioner, which contracts were sold during 1939, and which were held for a period of more than six months, was $242,200.03 more than their selling price when their basis and holding period are computed in accordance with the provisions of Section 118 of the Internal Revenue Code; but nothing contained in this paragraph shall constitute a concession by respondent of the legal conclusions

670 that the corn futures contracts in question were "capital assets" within the meaning of Section 117 of the Internal Revenue Code or that Section 118 applies thereto. See Exhibit 1-A attached hereto.

20. The basis of corn futures contracts purchased by petitioner, which contracts were sold during 1942, and which were held for a period of more than six months, was $87,628.75 less than their selling price when their basis and holding period are computed in accordance with the provisions of Section 117.

671 21. The basis of corn futures contracts purchased by petitioner, which contracts were sold during 1942, and which were held for a period of more than six months, was $75,163.13 less than their selling price when their basis and holding period are computed in accordance with the provisions of Section 118 of the Internal Revenue Code; but nothing contained in this paragraph shall constitute a concession by respondent of the legal conclusions that the corn futures contracts in question were "capital assets" within the meaning of Section 117 of the Internal Revenue Code or that Section 118 applies thereto. See Exhibit 1-A attached hereto.

672

22. The corn futures contracts in question were not subject to depreciation and were not included in inventory.

23. The raw corn storage capacity of petitioner in its own plants during 1942 of 2,303,000 bushels was less than three weeks' supply. The daily grind capacity of petitioner during 1942 was 170,000 bushels.

24. The annexed schedule (marked Exhibit 2-B) shows the monthly purchases of raw corn by petitioner from January, 1938 through December, 1942.

25. The annexed schedule (marked Exhibit 3-C) shows 673
the monthly purchases of corn futures contracts by petitioner from January, 1938 through December, 1942, inclusive, including the number of contracts, the number of bushels and the maturity dates, which futures contracts were disposed of by sale.

26. The annexed schedule (marked 4-D) shows the monthly purchases of corn futures contracts by petitioner from October, 1937 through December, 1942, inclusive, including the number of contracts, the number of bushels and the maturity dates, under which contracts delivery of the corn was taken. 674

27. The annexed schedule (marked Exhibit 5-E) shows the monthly sales of corn futures contracts by petitioner from January, 1938 through December, 1942, inclusive, including the number of contracts and the number of bushels.

28. During the year 1939 Maizena Brasil, S. A., a Brazilian corporation, declared a dividend and set up on its books as an account payable in the amount of 2,175,000$000 Brazilian Milreis to petitioner, its sole stockholder.

29. Various Italian corporations during the year 1939 675
declared dividends and set up on their books as accounts payable amounts aggregating 4,496,327.00 Italian lire to the petitioner, a stockholder thereof.

30. Petitioner converted the sums of 210,000 and 200,000 lire into dollars in November and December, 1939 at an average rate of approximately $.021 per lira. These lire would come out of dividends declared in 1936, if treated on a first in first out basis.

31. Respondent in determining excess profits net income for 1941 excluded therefrom $436,945.36 as constituting

676 abnormal income under Section 721 of the Internal Revenue Code; but in computing the unused excess profit credit carry-over from 1941 to 1942, did not exclude said $436,945.36 from 1941 excess profits net income. Petitioner had no excess profits tax liability for the year 1941.

32. It is agreed that by the use of certain terms in the stipulation and Exhibit 1-A, which connote the purchase and sale of corn futures contracts, the parties have used trade terms and by such use do not intend to suggest the legal consequence flowing from such transactions.

677 33. It is further stipulated that the record of the hearing in the proceeding before this Court between this petitioner and the respondent for the year 1940 (Docket No. 20399) shall be considered evidence in this proceeding without further proof, and

34. It is further stipulated that there were no significant changes in petitioner's method of doing business between December 31; 1940 and December 31, 1942 with respect to its corn futures transactions, its method of accounting therefor, and its established policy and method of selling its products to its customers.

678

35. During the year 1942 petitioner paid out as "salaries" the gross sum of $37,620.44 on which amount there was withheld and paid to the Treasury as Federal Old Age Benefit the amount of $357.39. The total sum of $37,620.44 was deducted in good faith as part of cost of sales, and was not disallowed in the notice of deficiency.

36. In addition there was paid to the Treasury as the employer's portion of Federal Old Age Benefit the amount of $357.39 and as Federal Unemployment Insurance the amount of $676.55 based on the said $37,620.44 which sums were deducted in good faith. The deduction of said two

sums of $357.39 and $676.55 were claimed and allowed by 679
the Commissioner as deductions.

37. The net amounts so paid were in fact embezzled by the paymaster and were not received by the employees designated on the checks as payees.

38. The embezzlements were discovered in 1948 by petitioner and a claim was made for reimbursement from its surety under its policy of insurance which was in effect at all times pertinent.

39. In 1949 petitioner received reimbursement of the 680
above sum of $37,620.44 from the surety under the terms of its policy without interest.

40. Respondent now makes claim to an additional deficiency based on the disallowance of said $37,620.44 as a deduction, and it is agreed that the answer shall be deemed to be amended in accordance with this contention and the contention deemed denied in a reply thereto.

41. During the year 1942 the petitioner had gross sales of over $131,000,000 and gross profits from sales of over $35,000,000. At the beginning and end of that year its 681
inventory (including raw corn and processed products valued at cost or market, whichever was lower) was about $7,650,000 and about $5,900,000, respectively.

42. It is further stipulated that any adjustments required by the decision herein under Section 734 shall be agreed upon by the respective parties and, in the absence of agreement, shall be submitted to the Court on Rule 50.

43. It is further stipulated that any adjustment to income for 1942 required by the decision herein with re-

682 spect to commodity futures transactions in 1942 shall be agreed upon by the respective parties and, in the absence of agreement, shall be submitted to the Court under Rule 50. The respondent now makes claim to any additional deficiency resulting from said adjustment.

JAY O. KRAMER
Attorney for Petitioner
c/o Milton M. Bernard
10 East 40th Street
New York 16, N. Y.

683

(Signed) CHARLES OLIPHANT
RPH.

Chief Counsel,
Bureau of Internal Revenue

684

Amendment to Stipulation.

685

[SAME TITLE.]

It is hereby stipulated by and between the parties hereto through their attorneys that Paragraph 28 of the stipulation submitted herein shall be deleted and in place thereof the following paragraph inserted:

28. During December, 1938 Maizena Brasil, S. A., a Brazilian corporation, declared a dividend, which was payable January 13, 1939, and set up on its books an account payable in the amount of 2,175,000$000 Brazilian Milreis to petitioner, its sole stockholder. 686

JAY O. KRAMER,
Attorney for Petitioner
c/o Milton M. Bernard
10 East 40th Street
New York 16, N. Y.

CHARLES OLIPHANT
RPH
Chief Counsel, 687
Bureau of Internal Revenue

EXHIBIT 4-A, ANNEXED TO STIPULATION OF FACTS.

CORN PRODUCTS REFINING COMPANY

SUMMARY OF ADJUSTMENTS OF CAPITAL GAINS OR LOSSES RESULTING FROM THE APPLICATION OF THE WASH SALE PROVISION OF THE INTERNAL REVENUE CODE, SECTION 118, TO TRADING IN CORN FUTURES CONTRACTS

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
	Contracts Sold		Selling Expenses			Book Profit or Loss Exclusive of Tax			Adjustment of Book Profit or Loss Through Application of Section 118 I. R. C.						
Year	Sales Price	Purchase Price	Commission	Tax	Book Profit or Loss	Total Book Profit or Loss	6 Months and under	6 to 18 Months	Wash Losses (Add'l. Costs)	6 Months and Under	6 to 18 Months	18 to 24 Months	Over 24 Months	Total Adjusted Profit or Loss	Wash Losses (Disallowed)
Domestic—United States															
1936	$ 589,900.00	$ 506,668.75	$ 700.00	$ 177.12	$ 82,354.13	$ 82,531.25	$ 82,531.25	$ —	$ —	$ 82,531.25	$ —	$ —	$ —	$ 82,531.25	$ —
1937	3,660,475.00	3,093,106.25	4,100.00	1,099.83	562,168.92	563,268.75	182,193.75	381,075.00	1,893.75	183,600.00	381,075.00	—	—	564,675.00	3,300.00
1938	9,434,281.25	10,229,806.25	19,937.57	701.46	816,164.03	815,462.57	599,240.70	216,221.87	421,593.80	10,606.24	70,049.99	—	—	59,443.75	1,177,612.62
1939	6,950,075.00	7,857,100.00	17,412.54	—	424,437.54	424,437.54	92,453.09	516,890.63	1,798,862.68	2,350.00	220,121.90	23,453.13	1,375.00	244,550.03	1,978,750.19
1940	8,866,006.25	8,167,637.50	17,781.36	—	680,587.39	680,587.39	192,271.81	488,315.58	1,341,067.36	34,384.39	96,712.49	1,393.75	204,056.35	140,334.50	520,145.47
1941	1,826,856.25	1,643,643.75	3,156.27	—	180,056.23	180,056.23	33,140.62	146,915.61	134,269.45	29,034.37	—	—	61,818.68	90,853.05	43,403.27
1942	4,845,025.00	4,946,787.50	8,206.88	—	109,969.38	109,969.38	197,598.13	87,628.75	75,741.29	606.25	75,163.13	—	—	75,769.38	261,480.05
Foreign—Argentine															
1936	3,008,946.96	8,257,010.48	In Pchse. Pr.	3,979.49	252,043.01	248,063.52	248,063.52	—	100,523.18	121,253.31	—	—	—	121,253.31	227,333.39
1937	754,769.07	727,698.47	" " "	599.95	26,470.65	27,070.60	27,070.60	—	126,810.21	98,048.80	1,690.81	—	—	99,739.61	—

Year 1942

Held less than 6 months.
Column (10) $ 606.25

Held more than 6 months
Column (11) $75,163.13

EXHIBIT 2-B, ANNEXED TO STIPULATION OF FACTS.

CORN PRODUCTS REFINING COMPANY

BUSHELS OF CORN PURCHASED AND RECEIVED AT PLANTS BY MONTHS FROM 1938 TO 1942, INCLUSIVE

691

Year	Month	Bushels of Corn
1938	Jan.	3,064,477
	Feb.	2,879,398
	Mar.	2,368,563
	Apr.	3,055,833
	May	2,685,153
	June	2,736,779
	July	3,289,083
	Aug.	3,288,062
	Sept.	2,712,331
	Oct.	3,445,493
	Nov.	3,278,544
	Dec.	2,847,057
	Total	35,650,773
1939	Jan.	3,037,694
	Feb.	2,440,180
	Mar.	2,446,592
	Apr.	3,357,578
	May	3,887,366
	June	2,709,739
	July	2,345,003
	Aug.	3,309,002
	Sept.	3,658,138
	Oct.	3,887,427
	Nov.	2,687,371
	Dec.	3,040,782
	Total	36,806,869
1940	Jan.	3,080,950
	Feb.	3,640,226
	Mar.	2,429,236
	Apr.	3,378,375
	May	3,627,996
	June	3,184,761
	July	2,806,706
	Aug.	2,554,081
	Sept.	3,354,589
	Oct.	3,016,840
	Nov.	2,669,977
	Dec.	3,478,672
	Total	37,222,409
1941	Jan.	3,868,474
	Feb.	3,586,175
	Mar.	3,807,450
	Apr.	5,200,664
	May	4,711,505
	June	4,626,307
	July	4,745,558
	Aug.	4,598,846
	Sept.	5,019,044
	Oct.	4,645,201
	Nov.	4,471,365
	Dec.	4,798,584
	Total	54,079,173
1942	Jan.	4,613,444
	Feb.	5,064,742
	Mar.	4,419,119
	Apr.	5,704,425
	May	4,816,199
	June	5,381,670
	July	5,160,793
	Aug.	5,111,121
	Sept.	4,848,466
	Oct.	5,398,031
	Nov.	4,913,260
	Dec.	5,330,243
	Total	60,761,513

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693

EXHIBIT 3-C, ANNEXED TO STIPULATION OF FACTS.

CORN PRODUCTS REFINING COMPANY

ANALYSIS OF CORN FUTURES CONTRACTS PURCHASED AND SOLD YEARS 1938 THROUGH 1940

File 141.8 Page	1938 Purchases Month	No. of Contracts	M. Bu.	MATURITY May, 1938 No. of Contracts	M. Bu.	July, 1938 No. of Contracts	M. Bu.	September, 1938 No. of Contracts	M. Bu.	December, 1938 No. of Contracts	M. Bu.	May, 1939 No. of Contracts	M. Bu.	July, 1939 No. of Contracts	M. Bu.	September, 1939 No. of Contracts	M. Bu.
44	January	93	1,670	13	265	1	40	79	1,365								
48	February	57	1,165	4	75	1	50	52	1,040								
52	March	71	1,945			3	115	63	1,750	5	80						
57	April	17	245					14	220	3	25						
58	May	51	1,205					19	435	32	770						
61	June	49	1,165			1	10			48	1,155						
65	July	150	3,960					5	1,050	112	2,095	33	815				
75	August	182	4,155							14	135	168	4,020				
87	September	97	2,080									89	1,975	8	105		
93	October	28	680							2	100	7	110	19	470		
95	December	29	1,405													29	1,405
		824	19,675	17	340	6	215	232	5,860	216	4,360	297	6,920	27	575	29	1,405

	1939 Purchases			July, 1939 No. of Contracts	M. Bu.	September, 1939 No. of Contracts	M. Bu.	December, 1939 No. of Contracts	M. Bu.	May, 1940 No. of Contracts	M. Bu.	July, 1940 No. of Contracts	M. Bu.	September, 1940 No. of Contracts	M. Bu.
99	January	60	2,495			60	2,495								
106	February	5	65			5	65								
106	March	16	535			16	535								
107	April	27	805	1	15	26	790								
110	May	1	10	1	10										
110	June	11	305					11	305						
111	July	81	1,640					13	215	68	1,425				
115	August	133	3,745							133	3,745				
126	September	100	2,160					7	190	75	1,620	18	350		
132	October	59	605							1	5	58	600		
134	November	53	1,195									53	1,195		
137	December	47	910									37	660	10	250
		593	14,470	2	25	107	3,885	31	710	277	6,795	166	2,805	10	250

	1940 Purchases			July, 1940 No. of Contracts	M. Bu.	September, 1940 No. of Contracts	M. Bu.	December, 1940 No. of Contracts	M. Bu.	May, 1941 No. of Contracts	M. Bu.	July, 1941 No. of Contracts	M. Bu.
141	January	89	1,720	11	115	77	1,600	1	5				
145	February	34	625	7	50	27	575						
147	March	33	440	1	5	32	435						
148	April	69	1,505			69	1,505						
153	May	74	1,465			74	1,465						
161	June	30	595					30	595				
162	July	2	100							2	100		
163	August	51	905					1	5	50	900		
165	September	34	475					14	105	18	355	2	15
167	October	21	295					3	40	1	5	17	250
		437	8,125	19	170	279	5,580	49	750	71	1,360	19	265

Exhibit 3-C, Annexed to Stipulation of Facts.

CORN PRODUCTS REFINING COMPANY

ANALYSIS OF CORN FUTURES CONTRACTS PURCHASED AND SOLD YEARS 1938 THROUGH 1942

File 141.8 Page	1941 Purchases Month	No. of Contracts	M. Bu.	MATURITY July, 1941 No. of Contracts	July, 1941 M. Bu.	September, 1941 No. of Contracts	September, 1941 M. Bu.	December, 1941 No. of Contracts	December, 1941 M. Bu.	May, 1942 No. of Contracts	May, 1942 M. Bu.	July, 1942 No. of Contracts	July, 1942 M. Bu.
169	March	32	455	29	405	3	50						
170	April	15	160	3	40	12	120						
170	May	2	20			2	20						
170	June	9	125			9	125						
171	September	87	1,090					29	345	58	745		
174	October	115	1,915					5	125	40	590	70	1,200
180	November	24	350							5	70	19	280
		284	4,115	32	445	26	315	34	470	103	1,405	89	1,480

File 141.8 Page	1942 Purchases Month	No. of Contracts	M. Bu.	July, 1942 No. of Contracts	July, 1942 M. Bu.	September, 1942 No. of Contracts	September, 1942 M. Bu.	December, 1942 No. of Contracts	December, 1942 M. Bu.	May, 1943 No. of Contracts	May, 1943 M. Bu.
182	February	8	80	8	80						
182	March	4	45			4	45				
182	April	39	535			39	535				
184	May	12	160			12	160				
185	June	62	1,185			7	155	55	1,030		
189	July	25	400			19	225	6	175		
191	August	75	1,460					4	30	71	1,430
195	September	63	1,860					16	375	47	1,485
201	October	78	1,905							78	1,905
206	November	18	745							18	745
208	December	6	300							6	300
		390	8,675	8	80	81	1,120	81	1,610	220	5,865

EXHIBIT 4-D, ANNEXED TO STIPULATION OF FACTS.

CORN PRODUCTS REFINING COMPANY

ANALYSIS OF CORN FUTURES CONTRACTS UNDER WHICH DELIVERY OF CORN WAS TAKEN YEARS 1937 TO 1942, INCLUSIVE

		Purchases			DELIVERY																
					May, 1938			July, 1938													
Year	Month	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value											
1937	Oct.	15	275	$ 167,256.25	15	275	$158,956.25														
	Nov.	62	780	445,968.75	37	505	281,468.75	25	275	$ 155,742.50											
	Dec.	12	160	93,725.00	7	55	29,453.75	5	105	61,462.50											
		89	1215	706,950.00	59	835	469,878.75	30	380	217,175.00											
					May, 1938			July, 1938			September, 1938			December, 1938			March.				
1938	Jan.	22	345	207,443.75	11	260	131,675.00														
	Feb.	9	100	61,287.50							11	85	$ 43,237.50								
	Mar.	4	155	98,037.50							9	100	51,575.00								
	Apr.	3	120	75,062.50							4	155	79,675.00								
	May	18	755	434,037.50	14	560	315,181.25				3	120	61,350.00								
	July	9	400	233,381.25							4	195	99,450.00								
	Aug.	49	1230	641,187.50				4	200	116,143.75											
	Sept.	27	510	264,025.00										5	200	$ 95,575.00					
	Oct.	23	705	353,006.25													8	500			
	Nov.	28	655	335,275.00																	
		192	4975	2,702,743.75	25	820	446,856.25	4	200	116,143.75	31	655	335,287.50	5	200	95,575.00	8	500			
					May, 1939			July, 1939			September, 1939			December, 1939			May, 1				
1939	Jan.	27	730	397,306.25																	
	Feb.	10	140	68,906.25							27	730	362,687.50								
	Mar.	11	165	80,206.25							10	140	79,350.00								
	Apr.	19	525	263,331.25							11	165	82,537.50								
	May	15	755	383,293.75	5	45	224,737.50	9	285	134,912.50	10	240	109,600.00								
	Sept.	11	285	148,475.00				10	310	146,650.00											
	Oct.	17	165	80,893.75										6	200	103,162.50	5	85			
	Dec.	4	100	52,250.00										2	10	5,212.50	15	155			
														4	100	52,437.50					
		114	2865	1,474,662.50	5	445	224,737.50	19	595	281,562.50	58	1275	634,175.00	12	310	$160,812.50	20	240			
					July, 1940			September, 1940			May, 1941										
1940	Jan.	5	30	17,018.75	5	30	$20,100.00														
	Feb.	1	10	5,475.00	1	10	6,700.00														
	May	3	55	36,912.50				3	55	34,512.50											
	Aug.	6	50	27,168.75							6	50	33,937.50								
	Sept.	6	85	51,737.50				1	55	34,675.00	5	30	20,662.50								
	Oct.	3	20	11,412.50							3	20	13,775.00								
		24	250	$ 149,725.00	6	40	$ 26,800.00	4	110	$ 69,187.50	14	100	$ 68,375.00								

EXHIBIT 4-D, ANNEXED TO STIPULATION OF FACTS.

CORN PRODUCTS REFINING COMPANY

ANALYSIS OF CORN FUTURES CONTRACTS UNDER WHICH DELIVERY OF CORN WAS TAKEN YEARS 1937 TO 1942, INCLUSIVE

DELIVERY

	July, 1938				September, 1938			December, 1938			March, 1939			May, 1939			July, 1939		
e	No. of Contracts	M. Bu.	Value		No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value
5.25			$																
8.75	25	275	155,712.50																
3.75	5	105	61,462.50																
8.75	30	380	217,175.00																
	July, 1938				September, 1938			December, 1938			March, 1939			May, 1939			July, 1939		
e	No. of Contracts	M. Bu.	Value		No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value
5.00					11	85	$ 43,237.50												
					9	100	51,575.00												
					4	155	79,675.00												
					3	120	61,350.00												
1.25					4	195	99,450.00												
	4	200	116,143.75					5	200	$ 95,575.00	8	500	$235,025.00	41	730	$349,312.50			
														27	510	244,025.00			
																	23	705	$334,875.00
																	28	655	310,775.00
6.25	4	200	116,143.75		31	655	335,287.50	5	200	95,575.00	8	500	235,025.00	68	1240	$593,337.50	51	1360	$645,650.00
	July, 1939				September, 1939			December, 1939			May, 1940								
e	No. of Contracts	M. Bu.	Value		No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value						
					27	730	362,687.50												
					10	140	79,350.00												
					11	165	82,537.50												
	9	285	134,912.50		10	240	109,600.00												
7.50	10	310	146,650.00																
								6	200	103,162.50	5	85	53,125.00						
								2	10	5,212.50	15	155	100,055.00						
								4	100	52,437.50									
7.50	19	595	281,562.50		58	1275	634,175.00	12	310	$160,812.50	20	240	$153,180.00						
	September, 1940				May, 1941														
e	No. of Contracts	M. Bu.	Value		No. of Contracts	M. Bu.	Value												
0.00																			
0.00																			
	3	55	34,512.50																
					6	50	33,937.50												
	1	55	34,675.00		5	30	20,662.50												
					3	20	13,775.00												
0.00	4	110	$ 69,187.50		14	100	$ 68,375.00												

Exhibit 4-D, Annexed to Stipulation of Facts.

CORN PRODUCTS REFINING COMPANY.

ANALYSIS OF CORN FUTURES CONTRACTS UNDER WHICH DELIVERY OF CORN WAS TAKEN, YEARS 1937 TO 1942, INCLUSIVE

		Purchases			DELIVERY								
					July, 1941			December, 1941			May, 1942		
Year	Month	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value
1941	Mar.	2	10	$ 6,068.75	2	10	$ 6,737.50			$			$
	Aug.	1	50	41,750.00							1	50	41,875.00
	Sept.	37	860	743,393.75				3	55	39,462.50	34	805	672,287.50
	Oct.	73	1,090	910,856.25				4	20	14,262.50	69	1,070	901,512.50
	Nov.	13	135	114,625.00							13	135	117,137.50
	Dec.	2	30	22,750.00				2	30	22,800.00			
		128	2,175	$1,836,443.75	2	10	$ 6,737.50	9	105	$ 76,525.00	117	2,060	$1,732,812.50
					July, 1942			September, 1942			December, 1942		
					No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value	No. of Contracts	M. Bu.	Value
1942	Feb.	5	105	$ 89,193.75	5	105	$ 86,881.25			$			$
	Apr.	37	585	522,431.25				37	585	485,781.25			
	May	54	1,480	1,339,350.00				54	1,480	1,239,500.00			
	June	6	460	408,631.25				6	460	383,775.00			
	July	19	825	724,768.75	13	710	621,918.75	6	115	95,762.50			
	Sept.	14	635	528,850.00				4	485	404,750.00	10	150	121,875.00
	Oct.	2	20	15,300.00							2	20	16,250.00
	Nov.	5	75	62,256.25							5	75	64,800.00
	Dec.	6	275	239,150.00							6	275	240,375.00
		148	4,460	$3,929,931.25	18	815	$708,800.00	107	3,125	$2,669,568.75	23	520	$ 443,300.00

EXHIBIT 5-E, ANNEXED TO STIPULATION OF FACTS.

CORN PRODUCTS REFINING COMPANY

706 SALES OF CORN FUTURES CONTRACTS BY MONTHS YEARS 1938 THROUGH 1942

Year	Month	Number of Contracts	M. Bushels
1938	Jan.	—	—
	Feb.	—	—
	Mar.	49	1,500
	Apr.	28	475
	May	38	755
	June	55	1,250
	July	185	4,050
	Aug.	164	3,795
	Sept.	111	2,480
	Oct.	49	1,035
707	Nov.	29	655
	Dec.	47	1,405
	Total	755	17,400
1939	Jan.	139	3,275
	Feb.	10	205
	Mar.	55	925
	Apr.	59	1,320
	May	—	—
	June	14	355
	July	26	1,265
	Aug.	68	3,035
	Sept.	51	1,230
	Oct.	27	375
708	Nov.	62	1,275
	Dec.	24	910
	Total	535	14,180
1940	Jan.	56	1,405
	Feb.	17	410
	Mar.	12	360
	Apr.	92	2,390
	May	49	665
	June	104	1,845
	July	159	3,000
	Aug.	91	1,910
	Sept.	88	1,620
	Oct.	39	790
	Nov.	9	100
	Dec.	12	100
	Total	728	14,595
1941	Jan.	—	—
	Feb.	—	—
	Mar.	—	—
	Apr.	52	1,025
	May	2	25
	June	51	710
	July	—	—
	Aug.	26	315
	Sept.	—	—
	Oct.	—	—
	Nov.	24	295
	Dec.	10	175
	Total	165	2,545
1942	Jan.	—	—
	Feb.	—	—
	Mar.	4	45
	Apr.	69	965
	May	66	1,070
	June	61	945
	July	—	—
	Aug.	48	650
	Sept.	46	680
	Oct.	68	1,400
	Nov.	—	—
	Dec.	—	—
	Total	362	5,695

Report of Proceedings.

709

[SAME TITLE.]

70 East 45th Street,
New York, N. Y.
Monday, June 18, 1951.

Met, pursuant to notice, at 11:10 o'clock, a. m.

BEFORE:

HON. CLARENCE V. OPPER, *Judge*.

710

APPEARANCES:

J. O. KRAMER, Esq.,
c/o MILTON BERNARD, Esq.,
and
SAMUEL ADAMS McCAIN, Esq., 17 Battery Place,
New York, N. Y.,
appearing for Petitioner.

10 East 40th Street,
New York, N. Y.,
appearing for Petitioner.

WALT MANDRY, Esq.,
and
MAURICE E. STARK, Esq., appearing for the Respondent.

711

PROCEEDINGS

The Court: Docket 22074, Corn Products Refining Company.

The Clerk: Please state your appearances for the record, gentlemen.

Mr. Kramer: J. O. Kramer, care of Milton Bernard, and Samuel Adams McCain, for the petitioner.

Mr. Mandry: Walt Mandry and Maurice E. Stark, for the respondent.

712 The Court: Proceed.

Mr. Kramer: This proceeding, your Honor, involves the calendar year 1942. The Commissioner asserts a deficiency in excess profits tax and in declared value excess profits tax in the amounts of $1,520,519.39 and $14,487.94 respectively. There are a number of issues here involved. The case will be submitted to the Court on a stipulation of facts and only one issue will be subject to oral testimony.

The first issue in the case is whether the petitioner Corn Products Refining Company's corn futures transactions during the year 1942 were capital transactions within the
713 meaning of Section 117 as contended by petitioner, or whether they were hedging transactions as contended by the respondent.

The second issue is whether, if the transactions were capital transactions, they were subject to Section 118, the wash sales provisions.

I might say during the year 1940 the same problems arose and that case was litigated before the Tax Court before Judge Murdock. The Tax Court decided in that case that Section 118 did not apply to these transactions, the wash sales provisions were not effective. Judge Mur-
714 dock felt it unnecessary at that time to decide whether Section 117 applied or whether they were capital transactions or whether the petitioner was engaged in hedging. This year the Court must decide that first issue.

I might also state at this point that petitioner made a motion in the 1940 case to have the entire decision reversed by the Court. That motion, although timely made, was denied.

The third issue, which is a compound issue, is whether the petitioner had income from Brazilian and Italian dividends in 1939. If petitioner had such income the excess profits credit of petitioner will be increased and the excess

profits credit carryover to 1942 will be similarly in- 715
creased.

The fourth issue in this case is whether this Court will follow its own rule in the San Francisco Stevedoring case. In 1941 petitioner had abnormal income arising out of a patent claim, the settlement of that claim. This income amounting to $436,945.36 was eliminated from excess profits net income in that year. The Commissioner agreed with that interpretation. However, the Commissioner refuses to make due allowance for that in computing the excess profits credit carryover to the year 1942; hence the issue of the San Francisco Stevedoring case.

The fifth issue in this case is whether petitioner cor- 716
rectly deducted the sum of $37,820.24 paid out as salaries in 1942. Actually what had happened was these sums were embezzled by a paymaster. They were not discovered until 1948. An insurance claim was put in and the money was recovered in 1949 at a time when the deficiency letter in this case had already been issued. Therefore, respondent is now asserting this as an affirmative claim and has the corresponding statutory burden of proving its case.

I would like very briefly, if I may, to go into the history of this litigation. The decision of the Tax Court in the 717
1940 case appears in 16 Tax Court No. 49. Decision was handed down February 20, 1951 by Judge Murdock, dealing only with the first two issues mentioned here. The Court, as I stated, felt it unnecessary to determine the first issue under Section 117, and that is the issue of whether the transactions in corn futures were capital transactions. The Court decided the second issue on Section 118, on wash sales, against the petitioner and in so doing Judge Murdock refused to follow the Trenton Cotton versus the Commissioner case in the Fourth Circuit. The petitioner's motion to review Judge Murdock's decision was denied although timely made, an issue your

718 Honor will have to decide, whether he wishes to follow Judge Murdock's opinion or whether he wishes to follow the three Judges in the Circuit Court.

The Court: Let me interrupt you there. So that I may be sure you understand, I will take this time to tell you that I have no choice on that subject. It is not a question of Judge Murdock's opinion not being the opinion of the Court because it was not reviewed. By custom and by statute that is the opinion of the Court unless it were to be overruled as any other opinion could be overruled. But it is no less an opinion of the Court.

719 Mr. Kramer: Incidentally, the 1940 proceeding is now awaiting Rule 50 computation.

Your Honor will of course have before him the opinion of the Court in the 1940 case and, as a matter of fact, the stipulation of facts will be presented to your Honor and will contain a stipulation that the entire record in the 1940 case shall be considered before the Court in this proceeding without further proof by either side, so that you will have ample opportunity to examine into that record. The Court, incidentally, in discussing the 117 issue said it was a difficult one.

There would be no purpose, therefore, since your Honor
720 will have the entire record and the opinion of the 1940 case before him, in making a decision, in my repeating all the facts with regard to the Section 117 and the Section 118 issue. All I need say is that it is respondent's contention that these transactions in corn futures were hedging transactions.

Petitioner states that was mathematically impossible, that it was not, and consequently a full series of cases will be cited to the Court in brief in support of petitioner's contention including Modesto Dry Yard case handed down last year in 14 Tax Court, which case was actually acquiesced in by the Commissioner.

I would like if I may briefly to develop the issue of em-

bezzlement and the embezzlement recovery. It will be 721
stipulated that the crime of embezzlement was not discovered until 1948 and that the claim for insurance was made in that year. Consequently when we received payment in 1949 the deficiency letter had already been issued in this case. There is a peculiar twist in this embezzlement issue, inasmuch as this petitioner actually withheld money for the payment of federal old age benefit and turned it over to the treasury in 1942. It also paid its own share of federal old age benefits and its share of the unemployment insurance, and paid it over to the treasury. There is no question that that happened. The only problem is: does the insurance recovery in 1949 prevent the 722
taking of the loss in 1942 even though petitioner did not know at the end of 1942 it had either a loss or the possibility of an insurance recovery. We submit the Cahn case in the Fourth Circuit on that particular score to point out to the Court here that it is the condition at the end of the taxable year which determines the possibility of insurance recovery. We claim in this case we could not even have known about an insurance recovery because we did not know about the loss. Consequently we claim we are permitted to take this deduction for salaries paid in the year 1942.

I have already developed the problem of the San Francisco Stevedoring case. I will not go into that further. That will be fully covered in the briefs. However, I would like to develop just for a moment the oral testimony which we will present in Court with respect to the foreign dividends. 723

We will show through the witness, the treasurer of this petitioner, that in 1939 petitioner had two Brazilian subsidiaries, Refinacoes De Milho, Brazil S. A. and Maizena, Brazil S. A. During the year 1938 Maizena declared a dividend payment to Corn Products Refining Company on January 12, 1939. This dividend was declarable for

724 the reason that Maizena had earned commissions from Refinacoes in 1938. We will show that a portion of that dividend was actually paid over to Corn Products Refining Company, this petitioner, in 1939 and that the balance was in effect loaned to one of the petitioner's subsidiaries, to wit, Refinacoes.

Originally, this matter was accounted for tax-wise in a most peculiar fashion. Neither the respondent nor I agree with the theory, but which was then prevalent in the Government; that was where you had income which might be blocked, reporting it at a zero basis, then in the

725 year you actually repatriate the money, reporting it as a capital gain. No one has been able to find any authority for that type of treatment, but that is the way this petitioner had consistently at the treasury's instructions, reported its dividends during this period from 1936 I believe through at least 1939.

With respect to the Italian dividends the testimony will show, among other things, that the dividends were declared and payable by various Italian subsidiaries. During the year, we will show that a large amount of lire were actually repatriated to the United States. We claim this proves convertibility.

726 In both the case of the Brazil and the Italian dividends we will rely on the Edmond Weil case, which incidentally dealt with the precise year we are now faced with, that is whether income is reportable in Brazil in the year 1939. That case dealt with the reporting of a capital gain in 1939. In that case the treasury had insisted that the income was reportable. The taxpayer insisted it was not. This Court and the Circuit Court of Appeals for the Second Circuit found it was reportable, which is the position that the taxpayer is now taking in this case.

The Court: Did the Foundation Company case deal with that, too?

Mr. Kramer: I believe it did, but not with this particu- 727
lar country in this particular year as the Weil case did.

The Court: It was Brazil, I believe.

Mr. Kramer: I don't recall whether it was 1939 or——

The Court: As I remember it was the early 30's.

Mr. Kramer: I know the Weil case deals with this identical year.

The dividends in the case of the Brazilian situation were declared and accrued in 1939, payable in 1939. There is an error in the stipulation of facts which respondent is aware of and we will ask when the stipulation is presented that the stipulation be corrected in that respect.

Before closing I want to thank the respondent's attorney 728
for his gracious help in this case in stipulating the facts which otherwise would have required an extended trial perhaps running into a week or two weeks.

Thank you very much.

The Court: I am very much obliged to both of you. We wish there were more stipulations of that nature.

I want to ask before you conclude: There are some 12 assignments of error. I have not read at least one of them carefully enough to be sure whether they are repetitious or not, but what I want to know from you is are there any assignments of error which are now being 729
pleaded?

Mr. Kramer: There are not. Those are mechanical assignments of error which would be alternatively pleaded and adjusted in a rule 50 computation.

The Court: But everything in the pleadings is still in issue?

Mr. Kramer: That is correct, your Honor.

Mr. Mandry: May it please the Court, Mr. Kramer has made a rather clear and fair statement of the issues in this case, and I do not think it would serve any particular purpose to rehash the various questions.

In response to your Honor's inquiry about the number

730 of errors assigned in the petition: there are some 12 assignments of errors in it, and I think that all those assignments will really boil down to about five issues; and in addition thereto there is another issue which is affirmatively raised by the respondent.

With respect to the first issue of the dealings in corn futures, it is our position that these were nothing more than hedging transactions and therefore constitute an exception to the provisions of Section 117. The respondent does not contend that this falls within the four enumerated exceptions to Section 117 but falls within that exception which has been brought about by many court decisions
731 and where there are hedging transactions the gains and losses are ordinary losses and ordinary gains.

The second issue relates to whether the provisions of Section 118 are applicable. As Mr. Kramer has stated, this Court in the case of Corn Products Refining Company, Inc., for the year 1940, 16 Tax Court No. 49, has decided this issue in favor of the respondent. As Mr. Kramer stated, Judge Murdock did not pass upon the question of the applicability of Section 117, and, as Mr. Kramer stated, he stated it was a very difficult problem. But he also stated that there was logic and common sense in the
732 respondent's position.

There is an alternative assignment of error here, and that is whether these future transactions constitute abnormal deductions under the provisions of Section 711 (B) (1) j) (ii) of the Internal Revenue Code. It is our position that they do not constitute such deductions.

Then there is the issue as to whether certain Brazilian and Italian dividends should constitute income in the year 1939. Mr. Kramer has stated some of the circumstances as to how these dividends were reported and treated. However, the petitioner in its income tax return for the year 1939 did not report these dividends as income in those years.

It is our position that due to the restrictions in Brazil 733
and Italy these funds were not available to the petitioner and that fact in conjunction with the method wherein the petitioner has treated these dividends by reporting them in subsequent years when realized, I think this issue should be decided in favor of the respondent.

Another issue deals with the embezzlement. In short, our position is that the petitioner was reimbursed by insurance for the entire amount of its loss and is not entitled to a deduction in 1942.

Mr. Kramer has referred to the fact that the petitioner also paid certain taxes on that amount. The petitioner 734
did and the petitioner deducted those amounts, and the petitioner was reimbursed for those amounts. Mr. Kramer also refers to certain unemployment insurance which the petitioner paid. That, of course, is separate from the embezzled amounts except it happened to be computed on the embezzled amounts, but the petitioner deducted that from his income tax return; and the respondent does not desire to make any change in that deduction, so that is not before the Court in so far as the unemployment insurance payments are concerned.

The last issue relates to the carryover of the unused excess profits tax credit based on the fact there was an 735
abnormal income.

We rely on the case of San Francisco Stevedoring Company with respect to that issue.

I believe that is all I care to state at this time, your Honor.

Also I wish to thank the petitioner. They were just as cooperative in preparing this case for trial.

Mr. Kramer: If your Honor please, Mr. Mandry and myself would like now to offer in evidence a stipulation of facts with annexed exhibits running from 1-A to 5-E.

The Court: The stipulation will be received.

Mr. Kramer: With respect to paragraph 28 of that

736 stipulation we would ask the Court to make note that the dividend was declared in 1938 in December, made payable on January 12, 1939, instead of as there stated.

The Court: So that oral amendment is agreed to, Mr. Mandry?

Mr. Mandry: That is agreed to, your Honor, and I was wondering as a matter of mechanics if it would not be desirable at the end of the trial for the parties to make necessary corrections in that paragraph.

The Court: What I prefer to have you do is prepare a short supplemental stipulation and file that because it is already in the record.

737 Mr. Mandry: Very well.

The Court: If you want to get it in in the form it should be annexed to the stipulation, I think it would be a good idea to do it that way.

Mr. Kramer: We will restate that particular paragraph. I did not want to offer proof contrary to that stipulation without first informing the Court.

In addition, petitioner and respondent would like to offer certain additional exhibits to bring the 1940 record down to date—that is to the end of 1942.

We would like to offer as a joint exhibit, Exhibit No. 738 6-F which is an analysis of stock and unfilled orders consisting of four pages.

The Court: It will be received and marked in evidence as one exhibit.

The Clerk: Joint Exhibit 6-F.

(Joint Exhibit No. 6-F is received in evidence.)

Mr. Kramer: Petitioner and respondent would like to offer in evidence Exhibit 7-G which brings down to date former Exhibit 7-G of the 1940 trial and shows the orders on hand and futures owned position of the petitioner during the year 1942 by means of a graph.

Colloquy of Counsel.

The Court: It will be received and marked in evidence 739
as one exhibit.

(Joint Exhibit 7-G is received in evidence.)

Mr. Kramer: Petitioner would like to offer in evidence as Exhibit No. 16 an exhibit of an agreement between Corn Products Refining Company and Huron Milling Company, dated June 1, 1942.

I would like to explain to the Court why we prefer if possible to call it No. 16. The exhibits in the previous trial ran through 15 and these exhibits which we have previously offered in evidence this morning merely bring 740
those exhibits down to date. This one is in addition to the record of the former case. Whether your Honor wants to call that Exhibit No. 8 or No. 16 it is entirely up to the Court.

The Court: I think we prefer to call the exhibit the next number, since it is not being marked in the other proceeding. If we should have other exhibits it would get us into trouble. We would like to carry on through with the numbering.

Mr. Mandry: No objection.

Mr. Kramer: No objection.

The Court: It will be received and marked in evidence 741
as Exhibit 8.

The Clerk: Petitioner's Exhibit 8.

(Petitioner's Exhibit No. 8 is received in evidence.)

Mr. Kramer: Now I would like to call as a witness Mr. Callender.

742 Whereupon,

H. L. CALLENDER

was called as a witness in behalf of the Petitioner, and having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address.

The Witness: H. L. Callender, Plainfield, New Jersey.

Mr. Kramer: I might state to the Court this testimony is produced solely with respect to the for-
743 eign dividend issued.

DIRECT EXAMINATION

By Mr. Kramer:

Q. What is your present occupation? A. I am treasurer of the Corn Products Refining Company.

Q. How long have you been with the petitioner? A. Thirty-five years last December.

Q. What was your position with the company in 1939?
744 A. I was chief accounting officer at the time. Chief accountant, I would say.

Q. Were you also assistant to the treasurer? A. Yes, sir.

Q. And in your capacity as chief accounting officer were you familiar with the books and records of Corn Products Refining Company and its subsidiaries? A. I was.

Q. Will you tell the Court whether the records of Corn Products Refining Company and its subsidiaries were kept on an accrual basis during the year 1939? A. They were kept on an accrual basis.

Q. Is that true— A. In 1939.

Q. Is that true of this entire period? A. Yes. 745

Q. Do you know the names of the two Brazilian subsidiaries, wholly owned by petitioner in this 1939 dividend matter? A. Yes. They were Maizena, Brazil S. A. and Refinacoes De Milho, Brazil S. A.

Q. You stated that both of these subsidiaries were wholly owned? A. Yes, they both were.

Q. During 1939 did Refinacoes De Milho owe Maizena any money for commissions? A. Yes.

Q. Do you know what happened with respect to those commissions from an accounting point of view? A. On the books of Maizena, Brazil S. A. the commissions were credited to P & L and debited to Refinacoes De Milho, a 746
current receivable.

On the books of Refinacoes the commissions were debited to profit and loss and credited to Maizena, Brazil S. A., a current liability.

Q. Do you know whether or not taxes were paid to Brazil by Maizena upon this commission income? A. They were.

Q. You are positive of that? A. Yes, sir.

Q. Do I understand correctly that Refinacoes De Milho is a New Jersey corporation? A. It is.

Q. And Maizena is a Brazilian corporation? A. That 747
is right.

Q. It is stipulated that Maizena declared a dividend of 2,175,000 milreis to Corn Products Refining Company payable January 12, 1939 or will be so stipulated. Will you describe what entries were made on the books of Corn Products Refining Company with respect to that dividend? A. On the books of the Corn Products Refining Company in June, 1939 we debited an account known as blocked account.

Mr. Mandry: I didn't hear that.

748 The Witness: We debited an account known as blocked account, Maizena, Brazil, S. A. That was an accounts receivable account. And we credited blocked income. That was a deferred credit income. In 1939 and in 1940 that dividend was paid, part in 1939 and the balance, the major portion of it in 1940; and at that time we debited cash and we credited the blocked account.

By Mr. Kramer:

749 Q. Do you know approximately how much was actually paid in 1939? A. Yes.

Q. Will your records which you have with you indicate that figure? A. The records indicate that we received in 1939 $4,862.31, the dollar equivalent of 100,649.9 milreis.

I might give the other entry we made.

Q. Please do. A. Having received the balance of the dividend in 1940, we proceeded to debit blocked income and we credited income, taking it into our book income in 1940.

Q. Did Refinacoes De Milho have sufficient assets to pay its commissions due to Maizena in 1939? A. Yes. Current

750 assets, yes.

Q. What was the end result of the entire transaction, disregarding the money that was actually paid to Corn Products Refining to which you have just testified? What was the end result? A. The balance unpaid at the end of 1939, the net result I would say was a loan to Refinacoes.

Q. The wholly-owned subsidiary? A. Yes. The net result.

Q. That was not Maizena the corporation that had declared a dividend? A. No, it was not.

Q. Do you know of your own knowledge what were the

rates of exchange accepted by the Bureau of Internal 751
Revenue as the current or market rate prevailing as of December, 1938, for milreis?

Mr. Mandry: I object to that, your Honor.

The Court: What grounds?

Mr. Mandry: On the grounds he is testifying as to what the rate of exchange was accepted by the Bureau, and I object unless he is qualified to state what the rate of exchange was accepted by the Bureau.

The Court: He has asked if he knows of his own 752
personal knowledge. I admit that is a little difficult for me to construe, but if he answers honestly he will either make a statement which will be admissible or he will have to say he does not know.

Mr. Kramer: May I rephrase the question, and I will simply ask the witness if he is familiar with the rates set out in the Internal Revenue Bulletin by the Commissioner as being the acceptable rate of exchange, using the very language if I may.

"The following rates of exchange are accepted by the Bureau of Internal Revenue as the current or 753
market rates of exchange prevailing as of December 30th as of that year."

By Mr. Kramer:

Q. Are you familiar with that rate as at the end of 1938? A. I am.

Q. What was that? A. At the end of 1938 it was 5.86 cents a milrei.

Q. What was it at the end of 1939? A. At the end of 1939 it was 6.058 cents a milrei.

Q. At what rate of exchange did you re[illegible]he amount

754 which you actually received in 1940? A. We booked the dividend.

Q. In 1939, I am sorry. A. We booked the dividend in 1939 at a rate of 5.95 cents a milrei.

Q. Turning to the problem of Italian dividends, did the petitioner have Italian subsidiaries in 1939? A. It did.

Q. Will you name the principal ones which were here involved in this case, if you can pronounce those names? A. S. A. Anticromos Dott Aldo Volpino-Milan. S. A. Ligure Industriale Commerciale-Genoa. S. A. Prodotti del Mais-Milan. Fabbriche Riunite Amido Glucosia Des-
755 trina-Milan.

Q. It is stipulated that dividends in the amount of 4,496,327 lire were declared payable in 1939 to Corn Products Refining Company.

Will you again explain to the Court how these sums were treated on Corn Products books and on the books of the various subsidiaries declaring them? A. Should I take each dividend separately? There might be a variation in the entries that were made.

Q. Please do so. A. The entry made by the Corn Products Refining Company on the dividend declared by S. A. Anticromos Dott Aldo Volpino-Milan was as follows: In
756 May of 1939 Corn Products Refining Company debited blocked account, which is an accounts receivable account, and they credited blocked income, which is a deferred credit to income, recording the dividend of 142,920 lire at 5.2625 cents per milrei, the published rate on date—published rate for milreis on the date the dividend was declared.

Q. You mean lire instead of milrei? A. I am sorry. Did I say milrei?

Q. Yes. A. Maybe I had better start again.

Q. Will you withdraw that answer, Mr. Callender, and start over again?

Mr. Kramer: Mr. Reporter, will you please read my question. 757

(Question read.)

The Witness: I will take the entry made on Corn Products Refining Company covering the dividend declared by S. A. Anticromos Dott Aldo Volpino-Milan in May of 1939: Corn Products Refining Company debited blocked account which is an account receivable account and credited blocked income covering 142,920 lire at 5.2625 cents per lire.

The published rate for the lira on the date the dividend was declared. The foreign affiliated company debited surplus with the dividend and it credited dividends payable. 758 It then proceeded to pay the dividend, and it paid 142,920 to the Corn Products Refining Company or for account of Corn Products Refining Company, and they paid the balance of 157,080 lire to the other stockholders.

Q. These were not wholly owned subsidiaries, then? A. No. This 142,920 lire that was paid, was paid to subsidiaries wholly owned known as Societe Finanziaria Agricola Italo-Americana-Milan for account of Corn Products Refining Company.

759 This company credited to Corn Products Refining Company and used the funds. Accrued interest. The company also accrued interest on it which was also credited to the Corn Products Refining Company.

Now I will take the next.

Q. Societe Finanziaria Agricola Italo-Americana-Milan was a wholly owned subsidiary of Corn Products? A. It was.

Q. The money was deposited in its account? A. The money was deposited to the credit of Corn Products Refining Company.

760 On the dividend declared by S. A. Ligure Industriale Commerciale-Genoa, the Corn Products in May of 1939 made this entry: It debited blocked account which is an accounts receivable account Finanziaria, and it credited blocked income to cover the dividend of 565,763 lire at 5.2625 cents per lire, the published rate for the lire on the date the dividend was declared.

The corresponding entry on the books of the Ligure Company was a debit to surplus to cover the dividend and a credit to dividend payable. The latter made a following entry, subsequent entry debiting dividends payable and

761 crediting cash.

Q. In what year was that? A. That was done in the year 1939, I believe. It credited Corn Products Refining Company with 565,763 lire and it paid cash, I believe, to the other stockholders in the amount of 384,237 lire. The 565,763 lire were paid to Societe Finanziaria Agricola Italo-Americana-Milan for account of Corn Products Refining Company.

Q. That is the same subsidiary? A. That is the same subsidiary.

Q. You previously named? A. This company credited the Corn Products Refining Company and used the funds.

762 It accrued interest on the funds which—and the acrued interest was also credited to the Corn Products Refining Company.

The Corn Products Refining Company on the dividend of S. A. Prodotti del Mais-Milan was as follows: it also was made in May of 1939 and it debited against blocked account Prodotti del Mais-Milan which was for accounts receivable account and it credited blocked income to cover 1,643,718 lire at 5.2625 per lire, the published rate for lire on the date the dividend was declared.

On the books of the crediting entry on the books of the Prodotti Company, was as follows: It debited surplus with

the dividend declared and it credited dividend payable, a 763
current liability on their books, with the Corn Products Refining Company's portion and the portion for the other stockholders.

The dividend declared by the Fabbriche Riunite Amido Glucosia Destrina Milan was recorded on the books of the Corn Products Refining Company as follows: this entry occurred also in May of 1939, and we debited blocked account Fabbriche, which was an accounts receivable account, and we credited blocked income which was a deferred credit to income to cover 2,143,926 lire at 5.2625 cents per lire, the official rate or the published rate, rather, 764
on the date the dividend was declared.

The crediting entry on the books of the Fabbriche Company was as follows: It debited the dividend to surplus and it credited dividend payable, a current liability, part of the credit being to the Corn Products Refining Company and part to its other stockholders.

Q. Now you mentioned the term "interest on these dividends." Will you state in what year that interest was accrued in each case? A. You will have to give me time to look at this account so I can pick it out.

Q. Maybe I can shorten the question. Was the interest accrued in 1939 in any case? A. I see an accrual of interest was—of $129—$60.54 in December, 1939. 765

Q. In which case is that? A. This is in the case of funds to the credit of Corn Products Refining Company in the Banca de America e de Italia.

Q. To summarize your testimony, can you state how these Italian dividends were treated with respect to payment or with respect to loans to other subsidiaries? Can you state in general what the approximate amount was in each case? A. Well, you would have to give me time to analyze these accounts. I do know that part of the dividends were turned over to the Banca de America e de

766 Italia for account of Corn Products Refining Company. Part was turned over to Banca Commerciale de Italia. Part to the National City Bank in Milan. And part to this Finanziaria Company. As to the amount applicable, I would have to spend some time analyzing these accounts.

Q. Do you know how the Italian and Brazilian dividends were actually reported on the petitioner's 1939 income tax return? A. Yes.

Q. Will you please explain to the Court how that treatment was made? A. They were reported as a zero value
767 with the dividend when received picked up as a capital gain.

Q. Was this the same treatment which had been given to dividends in previous years? A. Yes.

Q. Do you know whether or not it was in accordance with the examination by the Bureau of Internal Revenue for those years? A. I cannot answer the question.

Q. Do you know what the official rate of exchange was as set forth in the Internal Revenue Bulletin for the end of the year 1939? A. Yes, I know.

Q. Was that amount—what was that amount per lira? A. 5.0471 cent per lira.

768 Q. What was the value? What was the figure in 1938, if you have it? A. 5.2604 cents per lira.

Mr. Kramer: Thank you very much, Mr. Callender.

CROSS EXAMINATION

By Mr. Mandry:

Q. Mr. Callender, confining our examination at this time to the Brazilian dividends, I believe you stated that

the net result was that this was a loan from Maizena, 769
which was the corporation that declared the dividend, to Refinacoes? A. Yes, Refinacoes.

Q. Was that your testimony, that that was the end result? A. Will you repeat that question?

Q. I believe you said the end result was that the dividends declared by Maizena was a loan to Refinacoes? A. Refinacoes.

Q. Is that your statement? A. The net result, yes. It may be so construed.

Q. How did you figure that out? A. Well, on the books of the Corn Products Refining Company there was a debit to an account receivable known as Maizena, S. A. And on 770
the books of Maizena, S. A. there was a debit on its books to Refinacoes.

On the books of Refinacoes there was a credit to Maizena, S. A. Maizena, S. A. owed the Corn Products Refining Company this dividend, and Refinacoes owed Brazil —owed Maizena, Brazil the commissions. So it may be construed the money that was due Corn Products by Maizena was loaned to the Refinacoes Company.

Q. Those were just bookkeeping entries, were they not? A. That is right.

Q. Do you know whether there were any other debts 771
outstanding or moneys owed between these various corporations? A. Do I know what?

Q. Whether there were any debts or liabilities outstanding between these— A. They were.

Q. (Continuing) —three companies? A. They were.

Q. That is apart from this dividend and commission situation? A. Yes, that is right.

Q. You are aware, are you not, there were restrictions in Brazil in 1939 with respect to transmitting funds out of Brazil? A. I am. Yes.

Q. Now in 1939 you testified you did not report as in-

772 come any of the dividends in question. That is true, is it not? A. That is right.

Q. Do you know in what years you did report such dividends? A. Yes. In November of 1940.

Q. When were the funds actually transmitted to the petitioner in the United States? A. In 1939 and the major portion in 1940.

Q. What sum was transferred to the petitioner in 1939? A. I think I gave that.

Q. Is that the sum of $4,862.31? A. I think that is the figure I gave before. $4,862.31.

773 Q. Do you know the circumstances of the transfer of that sum to the United States? A. I do know we received a draft drawn by the Bank of Brazil, Banco do Brazil. I have a copy of the draft here. This draft was drawn by the Banco do Brazil on the Guaranty Trust Company in favor of Corn Products Refining Company for $1,620. It is dated December 20, 1939. That was supposed to be the milrei equivalent of 33,550 milreis. The payments we received were made in this fashion: we did not sell the exchange here in New York.

Q. You do not know who procured that draft, do you? A. No, I do not.

774 Q. Nor the circumstances under which it was procured? A. No, I do not.

Q. Are you aware there was in Brazil in 1939 an unofficial rate of exchange? A. Yes.

Q. Coming down to your Italian dividends, you have mentioned about four or five Italian companies? A. Four.

Q. Four? A. Yes.

Q. Now in any one of those dividends that was declared by Italian companies were any funds ever transmitted to the petitioner in the United States? A. Yes.

Q. What sum was that? I am now speaking of the entire dividends regardless of what company they came

from. A. Part of the blocked account that we had with Societe Finanziaria, part of that balance was transferred to the Banca de America for our account. 775

Q. You say it was transferred? A. It was transferred.

Q. To what bank? A. The Banca de America e de Italia.

Q. The Banca de America e de Italia? A. The Banca de America e de Italia for our account. I am coming to your question in just a moment. Part of the blocked account that we held against Prodotti del Mais was also transferred to the Banca de America. And part of the blocked account that we held with Fabbriche Riunite Amido Glucosia Destrina was transferred to the National 776
City Bank of Milan, Banca de America in Italy, and Banca Commerciale in Italy. These various bank accounts that we then acquired, we were able to sell here in New York some of the lire at an unofficial rate. I see an entry here where there was a sale of 200,000 lire in December of 1939 and a sale of 210,000 lire also in December of 1939 to foreign exchange traders here in New York. We also sold some lire in 1940 to the Chase National Bank and to other foreign exchange dealers.

Q. Now, with respect to the various dividends which were credited to your account and various banks in Italy, 777
those funds were still in Italy, were they not? A. Yes, sir.

Q. And you did sell lire amounting in dollars to approximately $8500, is that not true? A. I think so. It is 410,000 lire, I don't know the dollar equivalent.

Q. That could be computed from your rate, the rate that you used? A. Yes.

Q. Do you know the circumstances under which those sales were made? A. Well, they were sold here in this market. We were anxious at that time of course to realize dollars for our lire, and if anybody wanted to buy lire, we were willing to sell it at a price of course.

778 Q. That would have been true of the full amount of the dividends? A. Yes. Yes, it was.

Q. Would that also have been true of the Brazilian dividends? A. I think if we could have found a market here at perhaps a better rate, we would have negotiated the sale here in this market rather than in Brazil.

Q. To sum up your general treatment of these Italian and Brazilian dividends, as I understand your testimony, you reported those dividends in your returns from 1936 to 1938 with respect to dividends declared in those various years. That is true, is it not? A. Yes.

779 Q. In respect to your 1936 to 1938 dividends, those dividends were eliminated from your returns, were they not? A. They were shown at zero value, yes, for tax purposes.

Q. You did not in 1939 report this 1939 dividend except to that extent? A. The portion which was received we would have reported.

Q. Yes. Now, in your returns say for 1939, 1940, 1941, and 1942, have you not carried out that system of accounting for your dividends by not treating them as income in the year they were declared and payable but taking them up in the years when amounts were realized thereupon? A. You mean for book purposes?

780 Q. For your income tax purposes? A. I might review our practice. "If the foreign dividend payable to us was blocked by exchange restrictions our practice was to book the dividend as a receivable at the prevailing rate of exchange, offset by a credit to the deferred income, taking it into income in the year it was received."

That practice I believe has been consistently followed, and I know it is still followed. For tax purposes, however, I understand that blocked foreign dividends have at times been included as taxable income when payable and at times when received, depending on the attitude of the Bureau of Internal Revenue.

Q. That last statement is very general, Mr. Callender. 781
What I want to know specifically is—as I think you have testified—that in the year 1939 you did not report these so-called 1939 dividends, is that a fact? A. That is right. That is right.

Q. And you did in your later returns, whether that was 1940 or 1941 or 1942, include such dividends when they were realized on by the petitioner, is that true? A. That is true.

Q. That was your general— A. Yes.

Q. —practice? A. Yes.

Mr. Mandry: That is all. 782

Mr. Kramer: No further questions of this witness.

(Witness excused.)

Mr. Kramer: Your Honor, I have one other witness who may be able to clear up a point this witness could not answer. It will take about two minutes. No longer than that.

The Court: Very well.

Mr. Kramer: Mr. Gleason.

783

Whereupon,

DONALD H. GLEASON

was called as a witness on behalf of the Petitioner, and having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address.

The Witness: Donald H. Gleason, New York City.

784

DIRECT EXAMINATION

By Mr. Kramer:

Q. What is your present position? A. I am general tax executive of the Corn Products Refining Company.

Q. What are your duties as such? A. I have general supervisory line responsibility for the handling of all tax matters and report to the comptroller.

Q. Are you familiar with the examinations of the tax returns of the petitioner for the years 1936, 1937, 1938, and 1939? A. I am generally familiar.

785

Q. Are you familiar with the manner in which foreign dividends, particularly Brazilian and Italian dividends, were treated in those examinations? A. Well, in the later years of which you speak——

Q. Yes. A. After the Bureau's position in respect of the earlier years had become clear we did not include in our tax returns these items of blocked foreign exchange until we were able to convert them.

Q. How were they then treated? A. They were treated as short and long-term gains over a cost basis of zero with one exception. That was in respect of certain milrei converted in 1940 or I believe it was 1941.

786

Q. But this treatment you say was in accordance with the R. A. R.'s of earlier years? A. Yes. There were amendments made in respect of each year, if I recollect correctly, 1932 to 1937, but that general basis was——

Q. When I refer to R. A. R. you realize I am referring to revenue agent's reports? A. Yes, yes.

Mr. Kramer: Thank you.

Mr. Mandry: Just one question.

CROSS EXAMINATION 787

By Mr. Mandry:

Q. Mr. Gleason, when you state that was in accordance with the Bureau's position, what do you mean by that? A. I mean that in earlier years in Brazil, for example, we had set up dividends on the accrual basis for tax purposes. Then in connection with the revenue agent's reports for those earlier years they were taken out by the revenue agent of taxable income and nothing was taken to taxable income in connection with those reports until exchange was converted. 788

In respect of the year 1939 it was in following that general practice that we did not set up certain of these dividends referred to.

Q. So that was the result of your handling of the previous years with the revenue agent, was it not? A. Well, you can say that. I do not say that we were particularly happy about that particular thing at that time. It was just decided to let it go at that.

Q. And you agreed to do it? A. We did not take the cases to Court, sir.

Q. You agreed to it so far as the treatment thereafter was consistent with that position, was it not? A. Well, that is—that is a—they allowed them to be handled that way, yes, sir. 789

Mr. Mandry: That is all.

Mr. Kramer: No further questions.

(Witness excused.)

Mr. Kramer: Petitioner rests, your Honor.

Mr. Mandry: Respondent rests, your Honor.

The Court: What about briefs?

Mr. Kramer: I bow to Mr. Mandry's request on that.

790 Mr. Mandry: Your Honor, I would prefer simultaneous briefs in that I would like 60 days for opening briefs and 45 days for reply. I have worked that out because this is tied up a good deal with summer vacations.

The Court: Are you satisfied with that?

Mr. Kramer: Very much so.

The Court: Very well, 60 days for principal briefs; 45 days for each side to reply.

Will the clerk please read those dates?

The Clerk: August 17th for principal briefs; October 1st for the replies.

791 Mr. Kramer: We will submit that amended paragraph to your Honor before you return to Washington.

The Court: Any time while this term is still in session. Anything further?

Mr. Mandry: That is all, your Honor.

Mr. Kramer: No, sir, your Honor.

The Court: Marked submitted.

(Whereupon, at 12:30 o'clock, p. m., Monday, June 18, 1951, the hearing in the above-entitled matter was concluded.)

792

Joint Exhibit 6-F.

CORN PRODUCTS REFINING COMPANY

ANALYSIS OF "FEED SITUATION" FROM JANUARY 7, 1941 TO DECEMBER 21, 1942, INCLUSIVE (In Tons)

	1/7/41		1/13/41		1/20/41		1/27/41		2/3/41		2/10/41	
	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal
Stock	7,069	2,286	9,837	2,466	12,589	2,534	14,394	2,169	16,722	2,017	19,859	2,015
Unfilled Orders	18,267	3,865	16,176	3,673	13,859	2,925	22,989	5,569	19,386	4,797	16,947	4,367
	2/17/41		2/20/41		2/24/41		3/3/41		3/10/41		3/17/41	
Stock	22,223	1,761	23,362	1,973	24,255	2,448	22,651	2,680	24,400	3,163	26,107	3,273
Unfilled Orders	14,567	3,402	13,490	2,823	22,644	4,618	23,812	4,642	20,660	4,112	30,687	7,326
	3/24/41		3/31/41		4/7/41		4/14/41		4/21/41		4/28/41	
Stock	27,602	3,856	26,267	4,036	26,321	4,028	29,342	4,455	31,973	5,202	33,853	6,342
Unfilled Orders	29,138	6,663	24,407	5,769	20,986	5,576	28,234	7,493	27,700	8,137	24,532	7,281
	5/5/41		5/12/41		5/19/41		5/26/41		6/2/41		6/9/41	
Stock	34,254	7,373	36,595	8,061	37,610	8,577	39,384	9,284	34,379	9,064	30,066	9,199
Unfilled Orders	20,370	5,822	17,987	4,682	30,069	7,801	29,237	7,202	47,517	12,978	40,341	11,842
	6/16/41		6/23/41		6/30/41		7/7/41		7/14/41		7/21/41	
Stock	27,979	9,287	26,373	9,163	25,576	9,114	20,464	8,580	19,370	8,524	15,965	7,764
Unfilled Orders	36,115	11,152	34,564	10,474	39,427	10,143	33,473	8,611	45,454	12,724	39,448	11,032
	7/28/41		8/4/41		8/11/41		8/18/41		8/25/41		9/1/41	
Stock	16,470	8,710	14,441	8,397	13,981	9,359	14,623	9,260	17,263	9,665	16,866	9,121
Unfilled Orders	33,550	10,684	26,889	8,727	34,213	14,788	32,723	14,278	30,470	13,226	26,388	12,360
	9/8/41		9/15/41		9/22/41		9/29/41		10/6/41		10/13/41	
Stock	18,089	7,881	18,960	7,360	17,677	6,354	17,587	4,971	16,693	3,242	17,474	2,693
Unfilled Orders	50,193	19,123	52,945	21,870	45,443	19,632	40,511	17,214	33,705	13,181	27,126	10,270
	10/20/41		10/27/41		11/3/41		11/10/41		11/17/41		11/24/41	
Stock	18,534	2,857	21,720	2,929	21,750	3,620	23,257	4,359	22,999	4,536	22,199	4,376
Unfilled Orders	33,262	11,878	32,357	10,604	27,483	9,364	23,648	8,672	29,713	12,580	34,103	11,553
	12/1/41		12/8/41		12/15/41		12/22/41		12/29/41		1/5/42	
Stock	21,586	4,410	20,367	4,978	20,340	4,872	17,752	4,723	18,010	4,766	16,214	4,548
Unfilled Orders	31,361	10,094	25,305	8,411	49,671	16,543	44,620	15,144	41,491	13,841	35,146	12,321
	1/12/42		1/19/42		1/26/42		2/2/42		2/9/42		2/16/42	
Stock	16,054	4,841	13,488	3,773	10,540	2,623	7,401	2,396	6,206	1,848	6,351	2,040
Unfilled Orders	31,629	12,198	54,557	20,390	44,405	17,454	35,784	14,595	28,069	12,485	21,793	10,343

Joint Exhibit 6-F.

CORN PRODUCTS REFINING COMPANY

ANALYSIS OF "FEED SITUATION" FROM JANUARY 7, 1941 TO DECEMBER 21, 1942, INCLUSIVE (In Tons)

	2/23/42		3/2/42		3/9/42		3/16/42		3/23/42		3/30/42	
	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal	Feed	Gluten Meal
Stock	7,118	1,680	5,162	1,177	4,632	1,177	5,371	1,219	6,824	1,067	10,069	1,334
Unfilled Orders	40,710	17,716	32,380	14,832	25,750	12,139	21,214	9,304	26,939	13,696	29,349	16,589
	4/6/42		4/13/42		4/20/42		4/27/42		5/4/42		5/11/42	
Stock	11,688	2,032	12,970	1,809	12,584	1,621	12,807	1,580	11,477	1,581	11,840	1,818
Unfilled Orders	40,550	20,099	36,903	18,062	30,597	15,787	24,582	13,650	27,509	11,757	22,389	10,165
	5/18/42		5/25/42		6/1/42		6/8/42		6/15/42		6/22/42	
Stock	11,837	1,954	13,474	2,091	13,543	2,918	14,017	3,514	14,312	3,906	13,641	4,319
Unfilled Orders	17,446	8,223	31,296	12,408	27,525	11,374	26,741	8,984	22,034	7,231	40,203	11,921
	6/29/42		7/6/42		7/13/42		7/20/42		7/27/42		8/3/42	
Stock	14,881	5,212	13,377	5,080	13,079	5,034	12,226	4,942	11,753	4,969	9,957	4,927
Unfilled Orders	37,338	10,757	30,916	9,306	25,157	7,251	42,827	13,125	39,372	11,805	30,692	10,598
	8/40/42		8/16/42		8/24/42		8/31/42		9/7/42		9/14/42	
Stock	10,393	5,117	9,993	4,933	9,546	4,917	10,114	5,468	10,598	5,056	10,883	4,599
Unfilled Orders	25,269	9,090	43,282	13,603	40,442	13,451	35,786	11,723	29,588	9,875	26,371	8,772
	9/21/42		9/28/42		10/5/42		10/12/42		10/19/42		10/26/42	
Stock	9,922	4,324	9,557	3,800	8,047	3,368	7,407	2,572	6,649	2,372	6,228	1,897
Unfilled Orders	20,305	6,632	42,566	13,593	38,589	14,367	31,698	12,545	26,617	10,731	51,317	14,969
	11/2/42		11/9/42		11/16/42		11/23/42		11/30/42		12/7/42	
Stock	5,949	1,528	5,366	1,317	5,061	957	4,370	678	3,739	765	3,016	641
Unfilled Orders	43,823	12,928	35,219	11,194	27,566	8,811	19,254	6,954	41,292	10,590	34,292	9,166
	12/14/42		12/21/42									
Stock	2,273	435	2,253	756								
Unfilled Orders	26,356	7,454	19,973	5,456								

Joint Exhibit 6-F.

CORN PRODUCTS REFINING COMPANY

WEEKLY REPORTS, STOCKS, & ORDERS

(In Bushels) (000 omitted)

	1/1/41		1/12/41		1/19/41		1/26/41		2/1/41		2/9/41	
	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders
Cerelose	1,425	1,125	1,290	830	1,200	510	1,155	1,400	1,120	1,125	1,225	1,060
Bulk	1,210	925	1,190	950	1,210	780	1,185	700	1,130	575	1,260	660
Package	695	500	680	500	675	500	630	500	650	500	675	500
Total	3,330	2,550	3,160	2,280	3,085	1,790	2,970	2,600	2,900	2,200	3,160	2,220
	2/16/41		2/23/41		3/1/41		3/9/41		3/16/41		3/23/41	
Cerelose	1,275	750	1,365	520	1,280	1,050	1,340	1,845	1,320	2,040	1,335	2,075
Bulk	1,350	460	1,385	480	1,400	640	1,460	550	1,455	800	1,425	1,585
Package	690	500	700	500	730	500	730	500	775	500	680	500
Total	3,315	1,710	3,450	1,500	3,410	2,190	3,530	2,895	3,550	3,340	3,440	4,160
	4/1/41		4/6/41		4/13/41		4/20/41		4/27/41		5/1/41	
Cerelose	1,130	2,010	960	2,440	790	3,980	785	3,700	745	3,415	805	3,385
Bulk	1,460	1,770	1,460	2,080	1,450	1,990	1,475	2,790	1,500	2,350	1,525	2,220
Package	750	500	780	500	780	500	780	500	735	500	730	500
Total	3,340	4,280	3,200	5,020	3,020	6,470	3,040	6,990	2,980	6,265	3,060	6,105
	5/11/41		5/18/41		5/25/41		6/1/41		6/8/41		6/15/41	
Cerelose	765	3,010	810	2,750	880	2,510	890	2,220	940	2,210	960	2,210
Bulk	1,595	1,975	1,505	2,570	1,450	2,610	1,490	3,820	1,390	3,115	1,470	3,570
Package	670	500	635	500	600	500	610	500	585	500	550	500
Total	3,030	5,485	2,950	5,820	2930	5,620	2,990	6,540	2,915	5,825	2,980	6,280
	6/22/41		7/1/41		7/6/41		7/13/41		7/20/41		7/27/41	
Cerelose	1,010	3,360	980	3,915	970	3,650	880	3,290	740	3,070	650	2,460
Bulk	1,430	2,970	1,570	3,055	1,480	4,030	1,405	3,675	1,340	3,170	1,390	3,595
Package	510	500	520	500	520	500	575	500	610	500	600	500
Total	2,950	6,830	3,070	7,470	2,970	8,180	2,860	7,465	2,690	6,740	2,640	6,555
	8/1/41		8/10/41		8/17/41		8/24/41		9/1/41		9/7/41	
Cerelose	650	2,070	620	2,920	635	3,380	580	3,020	600	2,650	480	2,210
Bulk	1,500	3,190	1,630	2,460	1,730	3,095	1,695	2,745	1,765	2,870	1,800	2,810
Package	670	500	720	500	800	500	860	500	910	500	1,000	500
Total	2,820	5,760	2,970	5,880	3,165	6,975	3,135	6,265	3,275	6,020	3,280	5,520
	9/14/41		9/21/41		10/1/41		10/9/41		10/16/41		10/23/41	
Cerelose	455	2,070	430	1,870	420	1,755	435	1,665	500	1,565	525	1,605
Bulk	1,790	2,610	1,770	2,505	1,780	2,695	1,680	2,825	1,860	2,455	1,655	2,310
Package	1,015	500	1,045	500	1,010	500	1,090	500	1,110	500	1,140	500
Total	3,260	5,180	3,245	4,875	3,210	4,950	3,205	4,990	3,470	4,520	3,320	4,415

Joint Exhibit 6-F.

CORN PRODUCTS REFINING COMPANY

WEEKLY REPORTS, STOCKS, & ORDERS

(In Bushels) (000 omitted)

	11/1/41		11/6/41		11/13/41		11/21/41		11/28/41		12/1/41	
	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders
Cerelose	540	1,440	625	1,410	660	1,450	715	1,360	725	1,230	785	1,520
Bulk	1,925	2,010	1,940	1,700	2,060	1,820	2,170	1,500	2,245	2,270	2,335	1,940
Package	1,165	500	1,205	500	1,240	500	1,275	500	1,260	500	1,260	500
Total	3,630	3,950	3,770	3,610	3,960	3,770	4,160	3,360	4,230	4,000	4,380	3,960
	12/11/41		12/17/41		12/26/41		1/1/42		1/8/42		1/15/42	
Cerelose	840	1,645	860	1,925	890	2,220	900	2,160	850	2,190	830	2,100
Bulk	2,200	2,075	2,250	2,025	2,340	1,790	2,350	1,690	2,530	1,720	2,650	1,900
Package	1,290	500	1,330	500	1,340	500	1,310	500	1,250	500	1,230	500
Total	4,330	4,220	4,440	4,450	4,570	4,510	4,560	4,350	4,630	4,410	4,710	4,500
	1/22/42		2/1/42		2/5/42		2/12/42		2/19/42		3/1/42	
Cerelose	740	2,060	770	2,000	730	1,980	780	1,920	725	1,800	660	2,100
Bulk	2,650	1,660	2,720	2,000	2,790	2,020	2,810	2,000	2,885	2,010	2,850	2,090
Package	1,180	500	1,120	500	1,100	500	1,090	500	1,100	500	1,160	500
Total	4,570	4,220	4,610	4,500	4,620	4,500	4,680	4,420	4,720	4,310	4,670	4,690
	3/5/42		3/12/42		3/27/42		4/1/42		4/9/42		4/16/42	
Cerelose	610	2,180	630	2,190	615	2,074	625	2,070	611	1,973	572	1,912
Bulk	2,810	2,020	2,740	2,030	2,496	1,376	2,660	1,260	2,670	1,174	2,697	1,210
Package	1,070	500	1,030	500	967	612	935	500	894	500	899	500
Total	4,490	4,700	4,400	4,720	4,078	4,062	4,220	3,830	4,175	3,647	4,168	3,622
	4/23/42		5/1/42		5/7/42		5/14/42		5/21/42		6/1/42	
Cerelose	600	1,877	590	1,757	565	1,734	526	1,692	542	1,725	536	1,641
Bulk	2,840	1,206	2,946	1,223	2,991	1,820	2,941	1,641	3,063	1,775	2,815	1,781
Package	825	500	844	500	817	500	796	500	776	500	831	500
Total	4,265	3,583	4,380	3,480	4,373	4,054	4,263	3,833	4,381	4,000	4,182	3,922
	6/4/42		6/11/42		6/18/42		6/25/42		7/1/42		7/9/42	
Cerelose	499	1,780	465	1,858	526	1,842	489	1,903	470	1,930	435	2,130
Bulk	2,761	1,596	2,812	2,452	2,823	2,264	2,720	2,113	2,760	1,885	2,520	1,778
Package	817	500	817	500	877	500	891	500	930	500	900	500
Total	4,077	3,876	4,094	4,810	4,226	4,606	4,100	4,516	4,160	4,315	3,855	4,408

Joint Exhibit 6-F.

CORN PRODUCTS REFINING COMPANY

WEEKLY REPORTS, STOCKS, & ORDERS

(In Bushels) (000 omitted)

	7/16/42		7/23/42		8/1/42		8/6/42		8/13/42		8/20/42	
	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders	Stock	Orders
Cerelose	388	2,018	398	2,036	397	2,105	349	2,120	394	2,269	359	2,458
Bulk	2,500	1,662	2,444	2,707	2,469	2,733	2,447	2,715	2,345	2,613	2,339	2,681
Package	915	500	950	500	991	500	982	500	1,030	500	1,061	500
Total	3,803	4,180	3,792	5,243	3,857	5,338	3,778	5,335	3,769	5,382	3,759	5,639
	8/27/42		9/1/42		9/10/42		9/17/42		9/24/42		10/1/42	
Cerelose	337	2,401	342	2,386	377	2,133	348	2,040	327	1,988	352	1,890
Bulk	2,280	2,521	2,192	2,354	2,085	2,344	1,929	2,217	1,858	2,097	1,773	2,954
Package	1,023	500	1,009	500	1,046	500	1,061	850	1,042	850	1,053	850
Total	3,640	5,422	3,543	5,240	3,508	4,977	3,338	5,107	3,227	4,935	3,178	5,694
	10/8/42		10/15/42		10/22/42		10/29/42		11/1/42		11/12/42	
Cerelose	400	1,798	438	1,614	462	1,513	452	1,452	458	1,488	544	1,254
Bulk	1,642	2,798	1,574	2,524	1,479	2,460	1,368	2,469	1,328	2,596	1,261	2,547
Package	1,028	850	1,033	850	963	850	973	850	975	850	1,001	850
Total	3070	5,446	3,045	4,988	2,904	4,823	2,793	4,771	2,761	4,934	2,806	4,651
	11/19/42		11/26/42		12/1/42		12/10/42		12/17/42		12/24/42	
Cerelose	554	1,153	553	1,150	584	1,059	675	901	656	889	624	993
Bulk	1,135	2,545	1,041	2,946	990	2,740	1,122	2,720	1,026	2,658	1,052	3,652
Package	945	850	938	850	923	850	899	850	877	850	858	850
Total	2,634	4,548	2,532	4,946	2,497	4,649	2,696	4,471	2,559	4,397	2,534	5,495

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Joint Exhibit 7-G.

Graph for 1942, bringing up to date Joint Exhibit 7-G
809 received in evidence Tax Court Docket No. 20399 (1940).

(PHOTOPRINT.)

[*For the Convenience of Court and Counsel This Exhibit (Photostatic Copy) Is Bound in on the Opposite Page.*]

810

[redacted]

CORN PRODUCTS REFINING COMPANY - YEAR 1942

LEGEND

NOTES ON HAND - FROM WEEKLY REPORTS OF STOCK AND ORDERS

FUTURES OWNED - FROM DAILY CORN REPORTS

Petitioner's Exhibit 8.

814

AGREEMENT made this 1st day of June, 1942, between Corn Products Refining Company, a New Jersey corporation, hereinafter called "Seller", party of the first part, and The Huron Milling Company, a corporation of Michigan, hereinafter called "Buyer", party of the second part, this agreement amending and superseding an original agreement dated April 21, 1927, as amended.

NOW, THEREFORE, In consideration of the premises the parties hereto do hereby agree as follows:

815 1. *Quantity.* Seller agrees to manufacture and sell to Buyer or on its order, and Buyer agrees to purchase each year from Seller, a minimum of Fifteen Million (15,000,000) pounds of Thick and Thin Boiling Pearl and other Special Starches. Buyer shall have the right to purchase and Seller agrees to sell Buyer up to an aggregate of Seventy Million (70,000,000) pounds in any calendar year during the term hereof; provided that the total purchases of Thin Boiling Starch shall not be in excess of Thirty Million (30,000,000) pounds and the total purchases of Edible Starches shall not be in excess of Five Million (5,000,000) pounds in any calendar year,
816 nor shall Seller be obligated to deliver in any three consecutive months more than 25% of the total annual maximum quantities of all products.

2. *Quality.* Such of the foregoing products as are now manufactured by Seller shall be its usual standard quality; other products to be manufactured by Seller hereunder shall be made according to and in compliance with specifications, formulae, and manufacturing methods therefor furnished by Buyer. Buyer shall have the right to suggest changes in the specifications and formulae of the commodities specified in paragraph 1 or the manner of their processing to effect a lower cost and shall

be entitled to the savings resulting therefrom, except 817
that the quantities above mentioned may not be changed without the consent of Seller and Seller's proportional margin of profit on any commodity shall not be reduced below that realized by Seller at the date of this contract, nor shall the Seller be required to incur any expense in providing additional facilities or making changes in existing processes which interrupt or retard its regular rate of production.

3. *Shipments.* To destination as ordered by Buyer.

4. *Deliveries.* F. O. B. cars at any of Seller's factories 818
at Seller's option, freight adjusted to Chicago basis. In case of shipment in mixed cars with other products of Seller, Buyer to be charged proportionate cost of actual freight, cartage and warehousing.

5. *Price.* To be calculated on an estimated base price of $1.87 per one hundred pounds for Thick Boiling Pearl Starch (12% moisture) f. o. b. cars Chicago in bulk (except as hereinafter provided) when Seller's

cost of corn at Argo (16% moisture) is 70¢ per bushel, cost of coal at Argo is $3.00 per ton and 819
average hourly base rate of pay for labor (including Social Security taxes) in the Wet Starch House at Argo is 76½¢, and Seller's price for feed (Chicago) is $28.00 per short ton, and price for crude corn oil (Chicago) is $8.00 per one hundred pounds.

Such estimated base price shall be proportionately

increased or decreased at the rate of 3¢ per one hundred pounds for each corresponding increase or decrease of 1¢ per bushel in such cost of corn, also

820 increased or decreased, at the rate of 2¢ per one hundred pounds for each corresponding decrease or increase of $1.00 per ton in such price of feed, also

increased or decreased at the rate of 4¢ per one hundred pounds, for each corresponding decrease or increase of 1¢ per pound in such price for crude corn oil, also

increased or decreased at the rate of 2½¢ per one hundred pounds for each corresponding increase or decrease of $1.00 per ton in such cost
821 of coal, also

increased or decreased at the rate of ½¢ per one hundred pounds for each corresponding increase or decrease of 2¢ per hour in such average hourly base rate of pay for labor.

The estimated base price for Thick Boiling Pearl Starch (12% moisture) delivered in any calendar month, calculated as above provided, shall never exceed Seller's average market price for such product in bulk f. o. b. Chicago in the general market, exclusive of packages, during such month.

822 If, in any calendar month, Seller's costs, exclusive of the cost of corn, coal and labor, shall be over or under such costs as of June 1, 1942, to such extent as to render the base price charged for Thick Boiling Pearl Starch, delivered hereunder during such month, unfair or unjust to either party, such base price shall be correspondingly proportionately adjusted. In case the parties are unable to agree on the adjustments so to be made, such adjustments shall be determined by three arbitrators, one of whom shall be appointed by each of the parties hereto and the two so appointed

Petitioner's Exhibit 8.

shall select the third. The decision of a majority of such arbitrators shall be final. 823

All bags, barrels, cartons, packages, etc., to be added at cost plus average packing cost.

Buyer agrees to pay Seller for all products manufactured hereunder and delivered to Buyer, or on its order, the following differentials over such estimated base price of Thick Boiling Pearl Starch:

Ordinary and Edible Powdered Starches (10% moisture) 10¢ per one hundred pounds;

Thin Boiling Pearl Starch (12% moisture) 35¢ per one hundred pounds; 824

Thick or Thin Crystal Starches, either machine or hand packed, 45¢ per one hundred pounds;

Large Crystals requiring about two weeks to manufacture, 55¢ per one hundred pounds.

In case the differential existing on June 1, 1942, between Seller's general market price for Ordinary and Edible Powdered Starches, Thin Boiling Pearl Starch, Thick or Thin Crystal or Large Crystal Starches, and Seller's general market price for Thick Boiling Pearl Starch shall be increased or decreased in any calendar month, the price differential on such product, as above specified, shall 825 be correspondingly proportionately adjusted, provided, however, that Buyer's differential shall, at no time, be lowered to an amount which reduces Seller's margin of profit on such product (as customarily calculated) below that realized by Seller on Thick Boiling Pearl Starch delivered by Seller during such month.

In the event that the Buyer shall purchase from Seller any Special Starches for which a price differential over the estimated base price of Thick Boiling Pearl Starch is not provided in this contract, Seller agrees that the price differential

826 over such estimated base price shall, in no calendar month, exceed Seller's price differential on such products over its regular market price for Thick Boiling Pearl Starch in the general market prevailing during said month.

It is understood that finished products will analyze approximately 12% moisture. In case Thick Boiling Pearl Starch shipped to Harbor Beach for uses other than dry blending, analyzes greater or less than 12% moisture, the estimated base price for such starch shall be adjusted accordingly.

827 6. In the event that Buyer shall satisfy Seller that competition of other manufacturers has forced Buyer to sell any of such Special Starches during any calendar month at prices which shall average less than 15¢ per 100 pounds over the price charged by Seller for such product hereunder during such month, Seller shall reduce its price on such products to such sum as shall equal 15¢ per 100 pounds under Buyer's average selling price obtained therefor in the general market during such month, provided, however, that Seller shall not be required to make any reduction which would bring the price hereunder for such products more than 10¢ per 828 100 pounds under a sum equal to the estimated base price of Thick Boiling Pearl Starch, plus the differential applicable to such products hereunder.

7. It is understood that the secret specifications, formulae, and manufacturing methods which have been or shall be disclosed to Seller by Buyer, in carrying out the provisions of this contract, are the exclusive property of Buyer and that Seller will not use any of such specifications, formulae, or manufacturing methods, either directly or indirectly, in the manufacture of any of such products for itself or for others, nor disclose any thereof to any other person, firm, or corporation and that this

clause of this Agreement shall be binding during the 829
term of this contract and after the termination thereof. Provided, however, that nothing herein contained shall be construed to prevent Seller from manufacturing and selling similar products under any formulae, processes, or methods which it may now own or which may become commonly known or be acquired from others, or from using similarly made products as an ingredient in or base material for the manufacture of other products not now made by Buyer.

8. Seller agrees to manufacture and hold in stock reasonable quantities of the products to be made by 830
Seller under the specifications, formulae, or manufacturing methods furnished to it by Buyer hereunder. Buyer shall, however, from time to time notify Seller of the quantities of such respective products required to be kept in stock, which total quantities, however, shall at no time exceed two months' normal requirements of Special Starches and one month's normal requirements of Thin Boiling.

9. Seller shall not be liable for deliveries under this contract in case of strikes, shortage of cars, corn or fuel, extraordinary or excessive demand, or for any 831
other cause beyond its reasonable control, but in case Seller is not able to promptly fill orders for all of its customers, Seller agrees to give Buyer equal preference in shipments and fill Buyer's orders as promptly as possible, having due regard to all of Seller's customers.

10. Seller agrees to furnish buyer monthly statements showing the stocks of products held by Seller for Buyer's account on the last day of each preceding month.

11. Thick Boiling Pearl, Powdered and Edible Starches to be delivered by Seller hereunder are sold for the use of Buyer in its own manufacturing business and

832 not to be sold by it without Seller's consent except as the same have been so modified and blended with other products that they have become different in type or working quality.

12. Cost of corn, coal, labor and other items and Chicago price for feed and crude corn oil, used in making adjustments of the estimated base price for Thick Boiling Pearl Starch under the provisions hereof, shall be determined by the methods customarily adopted by Seller in the conduct of its business, which methods and the computations of adjustments thereunder shall at
833 all times be open to inspection by a representative of the Buyer.

13. All deliveries made by Seller hereunder in any one month shall be invoiced to Buyer as follows: Not later than the 7th day of the succeeding month, a preliminary invoice shall be sent carrying estimated prices of all the preceding month's deliveries and not later than the 27th, a final invoice shall be sent carrying definite prices. Payment by Buyer shall be made upon receipt of final invoice.

14. This contract shall commence on the 1st day of
834 June, 1942, and continue for the term of ten (10) years thereafter and until the 31st day of May, 1952, and at the option of the Buyer, to be exercised by giving written notice thereof to Seller on or before January 1, 1952, may be extended for an additional period of ten (10) years, making twenty (20) years in all unless sooner terminated by either party under the following conditions:

(a) In the event that the total amount of corn starch products purchased by Buyer from Seller in any calendar year during the term of this contract shall be less than fifteen million (15,000,000) pounds in the aggregate, Seller shall have the right

to terminate this contract by giving Buyer written notice eighteen (18) months in advance of such termination. 835

(b) In case either party hereto shall hereafter be consolidated or merged with any other corporation, or control of a majority of the voting capital stock thereof acquired by another corporation, either party may terminate this contract on twelve (12) months notice in writing given to the other.

15. This contract shall not be assignable by either party without the consent of the other. 836

16. This contract shall be deemed an amendment of and shall supersede and terminate the contract made between the parties hereto dated April 21, 1927.

IN WITNESS WHEREOF, the parties hereto have caused these presents to be duly executed the day and year first above written.

CORN PRODUCTS REFINING COMPANY
By (sgd.) LIMUS C. COGGAN
Vice President 837

Attest:

(sgd.) W. L. MORAN
Secretary

THE HURON MILLING COMPANY
By (sgd.) GEORGE J. JENKS
President

Attest:

(sgd.) G. G. SHIPLEY.
Secretary

Petition for Review.

838

THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 22074

CORN PRODUCTS REFINING COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

839

To the Honorable Judges of the United States Court of Appeals for the Second Circuit

COMES NOW Corn Products Refining Company by its attorneys, Jay O. Kramer, Esq., and Samuel A. McCain, Esq., and respectfully shows:

1.

JURISDICTION

840

That petitioner is a corporation organized under the laws of the State of New Jersey on February 6, 1906, with its principal office at 17 Battery Place, New York 4, New York.

That the income and excess profits tax return for the calendar year 1942 was filed with the Collector of Internal Revenue, Second District of New York, whose office is within the jurisdiction of this honorable Court. The Court in which review of this cause is sought is the United States Court of Appeals for the Second Circuit.

The petitioner files this Petition for review pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

841

2.

NATURE OF THE CONTROVERSY

The nature of the controversy is as follows:

Petitioner is a corporation organized under the laws of the State of New Jersey on February 6, 1906. It filed its income and excess profits tax returns for the year 1942 with the Collector of Internal Revenue, Second District, New York. The taxes in controversy were excess profits taxes in the amounts of $1,520,519.39, and $14,487.94, respectively.

842

Petitioner is a nationally-known corporation engaged in the manufacture and sale of corn products, including starches, sugars, syrups, oils and feeds. The maximum amount of raw corn which petitioner could store in its own plants during 1942 was 2,303,000 bushels, or approximately a three weeks' supply. The daily grind capacity of petitioner's plants during 1942 was 170,000 bushels. Similar conditions existed in prior years. It had been the custom of petitioner for a number of years prior to 1942 to purchase corn futures contracts. A corn future consists of a contract to buy 5,000 bushels of corn, or some multiple thereof, of a stated quality, at a stated price, for delivery during a stated month in the future. Such contracts called for delivery within eleven months or less from the date of contract. Such contracts are freely dealt with on various commodity exchanges, through brokers. The buyer furnishes his broker with margin, a percentage of the contract price. During the years prior to 1942, petitioner engaged in the purchase and sale of corn futures. It was found to be far less expensive to purchase corn futures by putting up a small amount of margin than to buy and store additional raw corn beyond petitioner's own limited capacity. The margin charges of

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844 futures contracts were less than storage and carrying charges in public elevators. This program also avoided financing the purchase of raw corn by large bank loans.

The corn futures contracts were not sold to customers in the regular course of petitioner's business but were disposed of through brokers on a regulated exchange, nor were such contracts included in inventory, neither were they subject to depreciation.

Petitioner suffered severe losses in the droughts of 1934 and 1936 when the price of corn rose sharply. One of its major products, cerelose, a refined corn sugar, competes with cane and beet sugar. Since it is a comparatively 845 new sugar, its price to the consumer is generally less than beet or cane sugar, with which it competes. The two droughts caused the cost of cerelose to rise out of proportion to its selling price. As a result in 1937, petitioner lost money on its cerelose sales. In an attempt to meet this condition, petitioner envisioned a plan or program in 1937 whereby it could buy corn futures whenever it considered the price of corn cheap and would establish a long futures position in the neighborhood of 12,000,000 bushels. This position would be built up and maintained during the year until it could be ascertained to some degree of cer- 846 tainty that no drought was likely to occur. The position would then be liquidated in part when, usually in July, favorable crop conditions were forecast.

The proposed plan was never put into full operation. Petitioner found it economically impractical to build up and carry the planned long position of 12,000,000 bushels. The Commodity Exchange Authority intervened in petitioner's program and objected to the size of petitioner's position in 1938. A complaint was brought by that Authority, which was dismissed in 1940.

In 1939, the outbreak of the European war rendered any plan unnecessary. The price of cane and beet sugar rose substantially due to war conditions, carrying with it

the price of cerelose. The need to stabilize the cost of 847
cerelose thereupon disappeared. The petitioner never was able to put its plan or program into full effect.

The petitioner's accounting practice was to account for its profits or losses on corn futures in an account called "Corn Miscellaneous", the balance in that account at the end of each year was debited or credited to cost of sales. In 1942, petitioner had a net loss of $109,969.38, which was treated in petitioner's return as an increase in the "cost of goods sold". In the four previous years, the transactions had resulted in the following gains or losses: 848

Year	Net Gain (treated as a reduction of cost of goods sold)	Net Loss (treated as an addition to cost of goods sold)
1938	———	$815,462.57
1939		424,437.54
1940	$680,587.39	
1941	180,056.23	

The general sales policy of petitioner at all times material, was to enter into contracts providing for shipment within thirty days. A price was named, but a provision was made that if the price in effect on the date of delivery was lower, the buyer was to have the advantage of such 849
lower price.

These facts give rise to two questions of law:

1. Were the transactions of petitioner in corn futures capital transactions under Section 117 of the Internal Revenue Code, and
2. Were such transactions subject to the "wash sales" provisions under Section 118.

A petition to review these identical issues is filed simultaneously herewith for the calendar year 1940. In addi-

850 tion to these issues, there are further matters in controversy.

During the year 1939, petitioner had certain subsidiaries in Brazil and in Italy. On January 12, 1939, Maizena, Brazil, S. A., a wholly owned subsidiary, declared a dividend payable in the amount of 2,175,000$000 Milreis. Petitioner actually received in the United States 100,649$900 Milreis in 1939. Petitioner made a loan of the dividend declared by Maizena, to another wholly owned Brazilian subsidiary, Refinacoes de Milho, Brazil.

In the same year, various Italian corporations declared
851 dividends in the sum of 4,496,327 Lire to petitioner, a stockholder thereof. During the year 1939, petitioner actually converted 410,000 Lire at 2.1c per Lira. Upon the declaration of dividends, monies were either deposited in bank accounts to the credit of petitioner or were turned over to other Italian subsidiaries of petitioner for use.

The Revenue Agent, in examining the years 1936 through 1939, required petitioner to treat the "blocked income" as being received at a basis of zero, and thereafter, to report as capital gain the amount received upon actual conversion into dollars. Petitioner seeks to treat the Italian and Brazilian dividends as income in 1939. The result of such
852 treatment would be to increase its excess profits credit and its excess profits credit carry-overs.

Another issue involves the question of petitioner's unused excess profits credit carry-over from 1941 to 1942. In 1941, petitioner had no excess profits tax liability. It did, however, have $436,945.36 of conceded abnormal income in 1941 attributable to pre-excess profits tax years. In computing the unused excess profits credit carry-over from 1941 to 1942, respondent did not exclude the amount of 1941 abnormal income, i.e., $436,945.36, from petitioner's 1941 excess profits net income, and as a consequence, the excess profits credit carry-over to 1942 was not increased by that amount.

The questions still in controversy are four: 853

1. Whether the purchase and sale of corn futures contracts by this petitioner were capital transactions, subject to the limitations of Section 117 of the Internal Revenue Code, or whether the gains and losses were from "hedges", resulting in ordinary income and ordinary deductions.

2. Whether the provisions of Section 118 which concerns "wash sales" has application to the corn futures transactions carried on by petitioner.

3. Whether petitioner had income in 1939 from Italian 854
and Brazilian dividends, thereby increasing its excess profits credit and its unused excess profits credit carry-overs for the year 1942.

4. Should the unused excess profits credit carry-over from 1941 be increased by the sum of $436,945.36, constituting conceded abnormal income in the year 1941, which respondent nevertheless did not exclude from that year's excess profits net income in computing the excess profits credit carry-over in 1942.

Respondent has found that there was a deficiency in excess profits taxes and declared value excess profits taxes 855
in the amounts of $1,520,519.39, and $14,487.94, respectively, against petitioner for the year 1942.

3.

PETITION FOR REVIEW

On March 9, 1948, petitioner filed with The Tax Court of the United States its petitions for redetermination of deficiency. Respondent filed its answer on April 20, 1949. The proceeding came on for a hearing on June 18, 1951,

856 and on June 30, 1952, the Court promulgated its initial opinion. It held that petitioner's transactions in corn futures were not capital transactions within the meaning of Section 117 of the Internal Revenue Code. The Court also found that the "wash sales" provisions of Section 118 of the Internal Revenue Code did not apply to petitioner's transactions in corn futures. The Court further found that petitioner did not sustain income in the year 1939 from dividends from Italian and Brazilian sources. The Court further found that the Commissioner did not commit error in including the net abnormal income for the year 1941 in excess profits net income for the purpose of
857 computing the unused excess profits credit carry-over to 1942. On other issues for which no review is sought, the Court held for the petitioner, except as to the computation of the amount of the relief. See 20 TC 68.

The Court entered its decision on the 15th day of June, 1953, and decided there is a deficiency of $1,221,879.44 in excess profits taxes, and of $14,487.94 in declared value excess profits taxes, respectively, for the year 1942.

4.

858 ASSIGNMENT OF ERRORS

Petitioner assigns as errors the following acts and omissions of The Tax Court of the United States:

1. The finding of The Tax Court of the United States that the transactions of petitioner in corn futures contracts during the year 1942 were not capital transactions under Section 117 of the Internal Revenue Code.

2. The finding of The Tax Court of the United States that the "wash sales" provisions of Section 118 of the Internal Revenue Code did not apply to petitioner's transactions in corn futures contracts for 1942.

3. The finding of The Tax Court of the United States 859
that petitioner did not have income in the year 1939 from Italian and Brazilian dividends, which would have had the effect of increasing its excess profits credit and its unused excess profits credit carry-over for the year 1942.

4. The finding of The Tax Court of the United States that the net abnormal income in the sum of $436,945.36 in the year 1941 should not be excluded from 1941 excess profits net income in computing the excess profits credit carry-over to 1942.

WHEREFORE, your petitioner petitions that the decision 860
of The Tax Court of the United States be reviewed by the United States Court of Appeals for the Second Circuit; that a transcript of the record be prepared in accordance with the rules of said Court and transmitted to the Clerk of said Court for filing; that proper action be taken to the end that the errors complained of may be reviewed by said Court.

Respectfully submitted,

/s/ JAY O. KRAMER
Jay O. Kramer 861
c/o Milton M. Bernard
10. E. 40th Street
New York 16, New York

/s/ SAMUEL A. McCAIN
Samuel A. McCain
17 Battery Place
New York 4, New York

(Verified June 23, 1953.)

Notice of Filing Petition for Review.

862

[SAME TITLE.]

To KENNETH W. GEMMILL,
Acting Chief Counsel,
Bureau of Internal Revenue.

You are hereby notified that the above-named petitioner did, on the 25th day of June, 1953, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Second Circuit, of the decision of this Court heretofore rendered in the above-entitled case. Copy of the petition for review as filed is hereto attached and served upon you.

863

Dated this 25th day of June, 1953.

(Signed) VICTOR S. MERSCH
Victor S. Mersch,
Clerk,
The Tax Court of the United States.

864

Service of copy of Petition for Review acknowledged this 25th day of June, 1953.

KENNETH W. GEMMILL
Chief Counsel. CAR

Bureau of Internal Revenue,
Attorney for Respondent.

Designation of Contents of Record on Review.

865

[SAME TITLE.]

To the Clerk of the Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Court of Appeals for the Second Circuit copies duly certified as correct of the following documents and records in connection with the petition for review heretofore filed by petitioner in the above entitled cause:

866

1. Docket entries of all proceedings before The Tax Court.
2. Pleadings before The Tax Court:
   (a) Petition filed the 9th day of March 1949, including annexed copy of deficiency letter and statement attached thereto.
   (b) Answer.
3. Findings of Fact, Opinion and Decision.
4. Official Report of Proceedings before The Tax Court, together with all exhibits in evidence and the partial stipulation of facts. 867
5. Petition for review, together with proofs of service of notice of filing and of service of a copy of petition for review.
6. This Designation of Contents of Record on Review.

868 Said transcript is to be prepared, certified and transmitted as required by law and the rules of the United States Court of Appeals for the Second Circuit.

JAY O. KRAMER
Jay O. Kramer
Attorney for Petitioner on Review
c/o Milton M. Bernard
10 East 40th Street
New York 16, N. Y.

/s/ SAMUEL A. McCAIN
869 Samuel A. McCain
Attorney for Petitioner on Review
17 Battery Place
New York 4, N. Y.

Admission of Service:

Receipt is hereby acknowledged and service is accepted this 8th day of July 1953 of the Designation of Contents of Record on Review filed in the above entitled cause.

870 (Signed) KENNETH W. GEMMILL CAR
Acting Chief Counsel

Bureau of Internal Revenue
Attorney for Respondent on Review

Certificate.

871

THE TAX COURT OF THE UNITED STATES

WASHINGTON

Docket No. 22074

CORN PRODUCTS REFINING COMPANY

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

Respondent. 872

I, Victor S. Mersch, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 146, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 29th day of July, 1953. 873

Last day to file record is August 17, 1953.

VICTOR S. MERSCH
Clerk,
The Tax Court of the United States.

(Seal)

[fol. 292] IN UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1953

Nos. 158 and 159

Argued May 13, 1954. Decided August 25, 1954

Docket Nos. 22809 and 22810

CORN PRODUCTS REFINING COMPANY, Petitioner

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

Before Chase, Chief Judge, Hincks and Harlan, Circuit Judges

Consolidated petitions to review decisions of the Tax Court redetermining a deficiency in the income taxes of the petitioner for 1940 and deficiencies in its excess profits taxes and declared value excess profits taxes for 1942. Affirmed.

Jay O. Kramer, Samuel A. McCain, Attorneys for Petitioner.

[fol. 293] H. Brian Holland, Assistant Attorney General, Ellis N. Slack, Lee A. Jackson, Harry Marselli, Special Assistants to the Attorney General, for Respondent.

OPINION

CHASE, Circuit Judge:

The petitioner, a New Jersey corporation which has its principal office in the City of New York, is engaged in manufacturing and selling corn products, including sugars, starches, oils and feeds. The Commissioner determined a deficiency of $163,804.78 in its income tax for 1940; a deficiency of $1,520,519.39 in its excess profits tax for 1942; and a deficiency of $14,487.94 in its declared value excess profits tax for that year. The Tax Court upheld the Commissioner and petitions to review its decisions have been consolidated for hearing in this court. The opinion of the Tax Court and its findings of fact as to the issues for 1940 are reported at 16 T. C. 395 and familiarity with them will

be assumed. Reference is also made to the unreported opinion and findings of fact of the Tax Court, as to the issues for 1942, in Tax Court Docket No. 22,074.

Four questions are presented as to the tax liability of the petitioner for the years 1940 and 1942. Involving both 1940 and 1942 are questions of the taxability of profits and losses in the purchase and sale of corn futures as ordinary income and loss or as capital gain and loss under Section 117(a) of the Internal Revenue Code, 26 U. S. C. A. § 117(a), and the applicability of Section 118 of the Code; 26 U. S. C. A. § 118, to those transactions. Involving only the tax year 1942, are two questions related to the petitioner's excess profits credit and carry-over.

In its business the petitioner uses large amounts of corn, often as much as 170,000 bushels per day. The maximum [fol. 294] amount of raw corn which it could store during the relevant periods was roughly 2,300,000 bushels, only about three weeks supply, so it decided to deal in corn futures in order to insure a stable price for the raw product by thus eliminating price fluctuations caused by occasional supply shortages on the market. The method adopted was to purchase corn futures through a commodity exchange whenever the price of corn was satisfactorily low and hold them until it could be ascertained whether there would be a crop shortage. Then the futures would be in part liquidated if, and when, need for retaining them ceased because of the condition of the anticipated crop. The method was followed each season.

The petitioner had future sales commitments, but these were mainly of an unfixed character in that the purchaser was given the benefit of the lower of the order price or the delivery date market price. So, with long purchases of futures set against future sales at the order or market price, whichever was lower, the respondent protected itself against commodity price rises but not against declines.

In the years 1940 and 1942 the petitioner's purchases and sales of corn futures resulted respectively in a gain of $680,587.39 and a loss of $109,969.38 and in its tax returns for those years these were treated as items of ordinary income and loss, being entered in petitioners' books as an increase and decrease in cost of goods sold. However, from 1940 to 1946 the Commissioner successfully contended in a

series of instances [1] that dealings in commodity futures contracts gave rise to capital, rather than ordinary, gains and losses and in reliance on those cases the petitioner sought [fol. 295] to have them treated as capital in nature under Section 117 (a) of the Code.

In addition to seeking capital treatment on these items the petitioner also contended that many of the past futures transactions came within the "wash sales" provision of Section 118 which would do away with loss deduction under Section 23(f) and transfer the basis of the "washed" security to the purchased security and, in this case, increase the basis of those futures sold in 1940 and 1942.

The Tax Court held that these commodity transactions gave rise to ordinary income and loss since the petitioner's system of purchasing corn futures "was an integral part of its manufacturing business." It is the position of the petitioner to the contrary that, within the meaning of Section 117(a), commodity futures contracts are "property held by the taxpayer" and do not come within the types of property excluded from the section, not being stock in trade, inventory, property held primarily for sale to customers, or the like, and therefore capital in nature.

In addition to those exclusions specifically provided for in Section 117 the petitioner contends that the courts have set up a "judge-made exception"; that is, that gain and loss from commodity futures transactions will not be given capital treatment when they have been utilized for the commercial purpose known as "hedging." And, even assuming that this "judge-made exception" is proper, it would not be applicable here because the petitioner, so it claims, was not hedging. We think the petitioner has misconstrued the effect both of the cases and of its own dealings.

Hedging is a method of dealing in commodity futures whereby a person or business protects itself against price

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[1] *George W. Covington*, 42 B. T. A. 601; aff'd 5 Cir., 120 F. 2d 768, cert. denied 315 U. S. 822; *Tennessee Egg Co.*, 47 B. T. A. 588; *Trenton Cotton Oil Co.* v. *Commissioner*, 6 Cir., 147 F. 2d 33; *Farmers & Ginners Cotton Oil Co.* v. *Commissioner*, 5 Cir., 120 F. 2d 772, reversing 41 B. T. A. 1083; *Makransky, Estate of Dorothy, Deceased, et al.*, 5 T. C. 397, aff'd 3 Cir., 154 F. 59.

fluctuations at the time of delivery of the product which it sells or buys. *United States* v. *New York Coffee & Sugar* [fol. 296] *Exchange*, 263 U. S. 611. A typical example of hedging occurs when a manufacturer of grain products seeks to stabilize its costs against fixed forward sales prices. Having contracts for the delivery of its grain products to its customers at fixed prices, the manufacturer seeks to set the cost of its related inventory item, grain, by entering into futures contracts for the purchase of it. By so doing the manufacturer may later obtain the necessary grain at a price properly related to the already fixed selling price of his manufactured product and, so far as commodity costs are concerned, the profit from manufacturing is insured.

In *United States* v. *New York Coffee & Sugar Exchange*, *supra*, the Supreme Court set forth three general classifications of dealings in commodity futures: speculation, legitimate capital transactions, and hedging. These classifications have since been adopted as convenient nominal guides by the courts to determine the proper tax consequences of futures transactions.[2] Where futures are dealt with for the purposes of speculation or what is called legitimate capital transactions, they obviously fall outside the possibly relevant exclusions of Section 117(a). In the hedge, however, the property is used in such a manner as to come within the exclusions, for it is a part of the inventory purchase system which is utilized solely for the purpose of stabilizing inventory cost. It is an integral part of the productive process in which the property is held not for investment but for the protection of profit with the intent of disposition when that purpose has been achieved. As such it cannot reasonably be separated from the inventory items and the cost (or profit) from such operations would necessarily be entered in the books of account of the business as part of cost of goods sold. The tax treatment of hedges, then, is not a "judge-made exception" to Section 117(a); [fol. 297] it is simply a recognition by the courts that property used in hedging transactions properly comes within the exclusions of the section.

The futures transactions of this petitioner, it is true,

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[2] See cases cited in footnote 1.

did not constitute what is known as "true" hedging. The true hedge can occur only when forward sales prices are fixed and the relation between commodity purchase and later sales price is insured against both increase and decrease of commodity prices. As the forward sales prices here were based mainly on the lower of order or market prices, the petitioner was protected only against increases in commodity prices and did not have the complete insurance of the true hedge. But this is a distinction presently of no significance. The property here was used for essentially the same purpose and in the same manner as in true hedging. Futures contracts were entered into to stabilize inventory costs and thus protect profit, and whether complete or only partial insurance was thereby obtained is simply a difference in degree, not in kind. Therefore, for the same reasons that the true hedge is not accorded capital treatment under Section 117(a), the kind of transactions with which we are now concerned are not to be regarded as capital ones either.

The petitioner's further contention that the wash sales provision of Section 118 is applicable to its futures transactions rests on *Trenton Cotton Oil Company* v. *Commissioner*, 6 Cir., 147 F. 2d 33, rehearing denied 148 F. 2d 208. With deference, however, we find ourselves unable to agree with that decision. Cf. *Harriss* v. *Commissioner*, 2 Cir., 143 F. 2d 279; *Valley Waste Mills*, 5 Cir., 115 F. 2d 466, cert. denied 312 U. S. 681.

Disallowance of loss deduction under Section 118 occurs only on the sale and purchase of "shares of stock or securities," and only if the stocks or securities purchased [fol. 298] are "substantially identical" with those sold. The transactions here are distiguishable on both grounds, for reasons well stated in the opinion below. On the question of substantial identity the Tax Court said: "Furthermore, a new future commodity contract is not 'substantially identical' with any prior contract even though the quantity involved in each is identical. It would be purely accidental if the new contract was with the same party as the one who had agreed to sell the commodity in the earlier contract. The price would probably be different and the delivery date would certainly be different." And on the

question of whether commodity futures contracts are securities: "it is apparent from the opinion (*Valley Waste Mills v. Page*, 115 F. 2d 466, cert. denied, 312 U. S. 681) that such a future is not a security in any generally recognized sense but simply a contract between two parties in which one agrees to supply at a designated time in the future a stated quantity and quality of goods, upon payment of a stated price and on which a part of the contract price, called a margin, has been paid by the buyer to his broker to bind him until the sale is consummated or the contract is sold * * *" We are in accord and take the above as the correct analysis and disposition of this point.

The third point raised by the petitioner is that the Tax Court erred in not holding that dividends declared by certain foreign corporations and payable to petitioner in 1939 were includible in its income for 1939. The effect of the inclusion of those amounts in 1939 income would be to increase petitioner's excess profits credit and its unused excess profits carry over to the year 1942, and thereby reduce the 1942 excess profits tax.

In 1938 a Brazilian corporation, wholly owned by petitioner, declared a dividend of 2,175,000 Brazilian milreis, payable in 1939. In 1939 four Italian corporations in which [fol. 299] the petitioner was a major stockholder declared and made payable to petitioner dividends totalling 4,496,327 lire. These dividends were, however, payable only in blocked currency. Consistent with its practice of treating blocked foreign dividends as income only when actually received in the United States in dollars, the petitioner entered these dividends on its books of account as deferred income and did not report them as income in 1939 for tax purposes.

In order to prove that the foreign dividends should have been included in 1939 income, it was necessary to show that instead of being blocked the dividends were in fact freely convertible into dollars. The petitioner offered as such proof the fact that in 1939 it had converted 100,649.9 milreis and 410,000 lire into dollars. There was no showing of the manner of conversion. The Tax Court held that this evidence was not sufficient to discharge the petitioner's burden of proof and accordingly held that the foreign dividends were not includible in 1939 income.

The petitioner insists that the Tax Court erred both in putting the burden of proof on the petitioner and in not holding its evidence of conversion of some milreis and lire into dollars to be sufficient proof of free convertibility. As to the burden of proof it is so well settled as not to need much comment that in proceedings before the Tax Court the petitioner must *affirmatively* establish its case. *Edward T. Weil, Inc.* v. *Commissioner*, 2 Cir., 150 F. 2d 950, on which the petitioner relies for the proposition is not in conflict with the general rule but recognizes expressly that, "The burden was upon the taxpayer to establish that the assessment of gain could not be made upon the basis of current exchange."

Rule 32 of the Rules of Practice before the Tax Court, 26 U. S. C. A. § 1111, provides: "The burden of proof shall be upon the petitioner, except as otherwise provided by [fol. 300] statute, and except that in respect of any new matter pleaded in his answer, it shall be upon the respondent." The issue of convertibility is not the subject of other legislation shifting the normal burden and here the issue was not new matter pleaded in the respondent's answer. Accordingly, the exceptions are inapplicable and the burden of proof was properly placed on the petitioner.

The evidence amply supports the Tax Court's conclusion that the petitioner failed to prove free convertibility. Only small portions of the dividends were converted into dollars, and the manner of conversion was not even shown. The entire remainder of the dividends was treated as deferred income. Such a showing, far from being adequate proof of free convertibility, tended to suggest the lack of it.

The final point raised by the petitioner is concerned with a determination with respect to abnormal income under Section 721 of the Code. But Section 732(c), which provides that any determinations made solely by reason of Section 721 of the Code are final and "shall not be reviewed or redetermined by any court * * *" deprives us of jurisdiction to review this determination. *George Kemp Real Estate Co.* v. *Commissioner*, 2 Cir., 182 F. 847, cert. denied 340 U. S. 852; *James F. Waters, Inc.* v. *Commissioner*, 9 Cir., 160 F. 2d 596, cert. denied 332 U. S. 767.

Decision affirmed except as to the final point and as to that the petition is dismissed for lack of jurisdiction.

[fol. 301] IN UNITED STATES COURT OF APPEALS, SECOND CIRCUIT

(T. C. 22074)

CORN PRODUCTS REFINING CO., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from The Tax Court of the United States

JUDGMENT—Filed August 25, 1954

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed except as to the point concerned with a determination with respect to abnormal income under Section 721 of the Internal Revenue Code and as to that the petition be and it hereby is dismissed for lack of jurisdiction.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

(S.) A. Daniel Fusaro, Clerk.

[fol. 302] [File endorsement omitted.]

[fol. 303] IN UNITED STATES COURT OF APPEALS, SECOND CIRCUIT

(T. C. 20399)

CORN PRODUCTS REFINING CO., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from The Tax Court of the United States

JUDGMENT—Filed August 25, 1954

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

(S.) A. Daniel Fusaro, Clerk.

[fol. 304] [File endorsement omitted.]

[fol. 305] [File endorsement omitted]

IN UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1953

Nos. 158 and 159

Argued May 13, 1954. Decided August 25, 1954

Docket Nos. 22809 and 22810

COHN PRODUCTS REFINING COMPANY, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Before Chase, Chief Judge, Hincks and Harlan, Circuit Judges

PETITION FOR REHEARING—Filed September 9, 1954

To the Honorable Judges of the United States Court of Appeals for the Second Circuit:

This is a consolidated appeal from the decision of The Tax Court which redetermined a deficiency in income taxes of petitioner for 1940 and deficiencies in its excess profits taxes and declared value excess profits taxes for 1942.

The Petitioner-on-Review respectfully petitions for a [fol. 306] rehearing and reconsideration of the decision of August 25, 1954, by this Court in the above entitled cases.

The grounds for this petition are:

Point I

On the issue of whether the petitioner's gains and losses on commodity futures transactions are capital or ordinary.

A. This Court failed to consider or distinguish *Estate of Dorothy Makransky* v. *Commissioner* (3rd Cir.—1946), 154 F. (2d) 59, a case directly in point.

In the *Makransky* case, the taxpayer who was engaged in the manufacture of men's suits incurred certain losses on the sale of contracts for the future delivery of wool tops. These were held to be capital losses despite the fact that the

taxpayer's purpose in acquiring the futures contracts was to take delivery of wool tops for manufacture into piece goods which would be manufactured into men's suits.

The basis of the decision is that since a *true* hedge did not exist, the commodity futures transactions must be treated by the taxpayer as capital.

The *Makransky* case is on all fours with the instant case.

This Court referred to the *Makransky* case (Opinion, p. 1791), but in no way discussed or distinguished it. It is respectfully submitted that the *Makransky* case cannot be distinguished or explained away satisfactorily. In the *Makransky* case, where it was to the Commissioner's advantage to contend that dealings in commodity futures gave [fol. 307] rise to capital losses, he did so and successfully. In the instant case, where it was to the Commissioner's advantage to contend that similar dealings in commodity futures did not give rise to capital losses, he did so, and if this Court refuses to reconsider its decison he will have done so successfully. It is respectfully submitted that an unnecessarily inconsistent and unfair situation is the result, and that if this Court had been clearly aware of the facts in the *Makransky* case and had considered it, it would not sanction such a result.

B. This Court failed to consider or distinguish *Commissioner* v. *Farmers and Ginners Cotton Oil Company* (5th Cir.—1941), 120 F. (2d) 772.

In the *Farmers and Ginners Cotton Oil Company* case, the Court, in holding that a *true* hedge did not exist and as a consequence that losses on the sales of commodity futures contracts constituted capital losses, said (p. 774):

> "Therefore, we need only examine the contention of the taxpayer which was upheld by the Board that the losses in controversy resulted from *true* hedges.
>
> "A hedge is a form of price insurance; it is resorted to by business men to avoid the risk of changes in the market price of commodities. The basic principle of hedging is the maintenance of an even or balanced market position. To exercise a choice of risk, to sell one commodity and buy another is not a hedge; it is merely continuing the risk in a different form." (Emphasis supplied.)

The Tax Court, in the *Makransky* case (reported at 5 T. C. 397, later affirmed at 154 F. (2d) 59), referred to the *Farmers and Ginners Cotton Oil Company* decision. The Court denied ordinary loss treatment to the taxpayer for failure to prove a *true* hedge. The Tax Court stated at page 413:

> "Certainly in the latter case [*Farmers and Ginners* [fol. 308] *Cotton Oil Company*] the transactions of the taxpayer more nearly resembled a *true* hedge than those of the instant case [*Makransky*]; yet the Court held against the taxpayer." (Matter in brackets and emphasis supplied.)

The Court in the instant case has itself stated that the petitioner did not have a *true* hedge (because of the "unfixed character" of petitioner's future sales commitments and because of the irregular nature of contract order cancellations); that as a result of its commodity futures transactions it was protected against commodity price rises but not against declines. What "kind or degree" of hedge is that, petitioner respectfully asks?

The contention made by the Commissioner and sustained by the 3rd and 5th Circuit Courts of Appeal in the *Makransky* and *Farmers and Ginners Cotton Oil Company* cases, *supra*, is the heart of the petitioner's position in the instant case. If taxpayers are forced by the Commissioner (supported by the Courts) to take capital losses unless they can prove a *true* hedge, it follows legally, logically, consistently, and most of all, as a matter of simple honesty and fairness, that they should be permitted to treat their commodity futures transactions that do not amount to a *true* hedge as capital transactions.

This Court, although it referred to the *Farmers and Ginners Cotton Oil Company* case (Opinion, p. 1791), did not distinguish or explain away the holding. It is respectfully submitted that if this Court had thoroughly considered that case, its rationale and implications, it would have accorded capital treatment to the results of commodity futures transactions where a *true* hedge does not exist.

[fol. 309] C. This Court failed to consider or distinguish *Trenton Cotton Oil* v. *Commissioner* (6th Cir.—1945), 147 F. (2d) 33.

In that case the question was whether the taxpayer's contracts for the purchase of refined oil futures were made to protect it against loss on the purchases of cotton seed or on the sale of crude oil for future delivery. The taxpayer had contended that the refined oil futures were purchased to offset losses sustained through the sale of the season's production of crude cotton seed oil at unsatisfactory prices. Both The Tax Court and the Court of Appeals refused to allow the taxpayer ordinary loss treatment.

The Court of Appeals affirmed The Tax Court finding that the taxpayer's purchases were not for protection on the ground that there was substantial evidence in support of The Tax Court's decision. The Tax Court had said in its Memorandum Opinion:

> "These quotations, petitioner insists 'seem to say that if the *Farmers and Ginners Cotton Oil Company* had actual commodity on hand and actual commitments to be protected against, that would amount to a *true* hedge'. We do not agree." (Emphasis supplied.)

Thus The Tax Court, affirmed by the Circuit Court, insisted that the test was whether there was a *true* hedge. Lacking such proof, the transaction was treated as a capital transaction.

D. Summary

The *Makransky, Farmers and Ginners Cotton Oil Company* and *Trenton Cotton Oil* cases contain four factual elements referred to by this Court in its holding:

(1) All cases involve commodity futures transactions. [fol. 310] (2) In all cases the transactions were an integral part of the business of the taxpayer.

(3) In all cases the transactions were made to protect the ordinary profits of the taxpayer.

(4) In all cases the decision of the Courts turned on whether or not there was a *true* hedge.

The conclusion in this case should not be inconsistent.

Point II

On the foreign exchange issue this Court has neither considered nor distinguished the *Whitney* case decided by the Third Circuit as to burden of proof.

This Court has held that petitioner did not have income from Brazilian and Italian dividends during 1939 on the ground that it failed to prove free convertibility.

Petitioner recognizes that under Rule 32 of the Rules of Practice before The Tax Court that it had the initial burden of proof on this issue. Petitioner's position is that once it had shown the receipt of the funds in a foreign currency and the fact that it was able *to convert* a portion of those funds at a price (R. 749 and 776), *and had actually used* the remainder for corporate purposes (R. 750, R. 759, and R. 762), it was incumbent upon respondent to produce competent evidence as to why income had not been received. The record shows that the respondent produced no evidence on this point.

Petitioner urges that the decision of the Third Circuit in *Richard Whitney* v. *Commissioner* (3rd Cir.—1934), 73 F. (2d) 589, be followed or distinguished.

> "The burden of proof was on the Petitioner before [fol. 314] the Board and if he met it the burden shifted and the Government was required to come forward with evidence to refute the evidence of the Petitioner. It did not do so and the Board cannot draw inferences and conclusions from facts or suppositions outside the record."

This Court misinterprets petitioner's position with respect to this issue. The real problem is not whether the petitioner had income, but how much income did petitioner have. This Court's decision in *Eder* v. *Commissioner* (2nd Cir.—1943), 138 F. (2d) 27, is exactly in point when it held:

> "Absent any showing that there are no such bases, [bases of value in U. S. dollars of various uses which could have been made of blocked pesos] it might perhaps be said that the taxpayers must lose this appeal because they did not discharge their burden of proof.

In the circumstances, we consider that such a ruling would be too severe. We, therefore, remand the case to The Tax Court for further consideration of the appropriate measure of valuation * * *." Matter in brackets supplied.)

Petitioner submits that the undisputed evidence shows that the reason it did not convert more of the foreign exchange into dollars was purely on considerations of price as against the value of other uses to which the funds were put. On cross-examination the witness, Holly L. Callender, Treasurer of the petitioner, testified (R., p. 260):

"Question: Would that also have been true of Brazilian dividends?

Answer: I think if we could have found a market here at perhaps a better rate, we would have negotiated the sale here in this market rather than in Brazil."

The question then was of petitioner's unwillingness to [fol. 312] sacrifice its foreign exchange for dollars at an unfavorable rate when it had other uses of value to it (R. 750, R. 759, R. 762, R. 777, and R. 778). In each instance, the funds from dividends were loaned for business purposes to a subsidiary of petitioner other than the subsidiary which declared the dividend.

Petitioner, therefore, submits that having shown that it could have converted and did convert the foreign currencies in question in dollars at a price and did actually use the unconverted funds, it had sustained its burden of proof and that it was then incumbent upon respondent to go forward.

Point III

On the issue of the jurisdiction of a Court of Appeals to determine the correct carry-overs of unused excess profits credit this Court has not considered or distinguished contrary decisions of the Sixth, Eighth, and Ninth Circuits in parallel situations.

This Court has held that it does not have jurisdiction to consider the effect of petitioner's abnormal income, realized in 1941, on its excess profits credit carry-over

from the same year. This Court, it is respectfully urged, has misread Section 732(c). The issue before this Court does not concern Section 721 as such. The existence of abnormal income under Section 721 has been conceded by the respondent in the amount of $436,945.36 (R., p. 210, Folio 630). The only issue is the correct computation of petitioner's excess profits credit carry-over, which is determined by Section 710(c). The determination of the issue here is, therefore, not "necessary *solely by reason* of * * * Section 721." (Emphasis supplied.)

Under similar circumstances, other Courts of Appeal have held that they do have jurisdiction to review the de- [fol. 313] cisions of The Tax Court. In *Stimson Mill Co.* v. *Commissioner* (9th Cir.—1947), 163 F. (2d) 269, and in *Dowd-Feder, Inc.* v. *Commissioner* (6th Cir.—1949), 173 F. (2d) 673, the petitioners having been allowed relief under Section 722 claimed further relief under Section 713(e)(1) (the so-called 75% rule), alleging that in computing the excess profit credit the reconstructed base period income under Section 722 should be used in raising the lowest base period year to 75% of the average of the other base period years. The respective Courts of Appeal, over objection from the Government as to jurisdiction, ruled that they did have power to review a collateral consequence of the application of Section 722. They held that both Sections 722 and 713(e)(1) were involved and that, therefore, the question did not rise solely by reason of Section 722. So here, the petitioner's claim arises under Section 710(c) as well as under Section 721. See also *Packer Publishing Company* v. *Commissioner* (8th Cir.—1954), 211 F. (2d) 612, where the Court asserted its own jurisdiction to review The Tax Court, as well as the jurisdiction of The Tax Court itself to pass on a collateral consequence of Section 722 relief. There the allowance of Section 722 relief increased the profit (after tax) of the taxable year and hence an officer who was employed on a profit sharing contract became entitled to a larger bonus. The petitioner claimed a deduction for this additional bonus—presumably as a business expense under Section 23(a)—and the Appellate Court, again over Government objection to jurisdiction, ruled that it could review The Tax Court's refusal to make the claimed adjustment.

The above cases were all cited by the petitioner in its brief, but this Court has not discussed or referred to them in any way. This Court did rest its decision on *George Kemp Real Estate Company* v. *Commissioner* (2nd Cir.—1950), 182 F. (2d) 847, and *James F. Walters, Inc.* v. *Commissioner* (9th Cir.—1947), 160 F. (2d) 596. Petitioner respectfully urges that the present case is distin- [fol. 314] guishable from them. These cases held that the Appellate Court had no power to review decisions of The Tax Court holding that Sections 722 and 721 respectively were not applicable. *No other Section of the Code was involved.* If petitioner were appealing from an adverse decision of The Tax Court with respect to the existence or amount of its net abnormal income, these cases would apply. But that net abnormal income is here conceded. The question is how it should be applied under Section 710(c). Under these circumstances, the jurisdiction of this Court to review The Tax Court and to pass upon the correctness of *San Francisco Stevedoring Co.* (1947), 8 T. C. 222 is established.

Conclusion

Petitioner respectfully requests that in order to prevent an injustice, this petition for rehearing be granted and the opinion of the United States Court of Appeals for the Second Circuit of August 25, 1954, be recalled and, upon further consideration, amended to reverse the decisions of The Tax Court.

Respectfully submitted, Jay O. Kramer, Attorney for Petitioner % Milton M. Bernard, Samuel A. McCain, Attorney for Petitioner.

Harry J. Rudick, Of Counsel.

Dated: New York, New York, September 9, 1954.

[fol. 315] Certificate of Counsel

We, JAY O. KRAMER and SAMUEL A. MCCAIN, counsel for the above named petitioner, do hereby certify that the foregoing Petition for a Rehearing of this cause is presented in good faith and not for delay.

Jay O. Kramer, Attorney for Petitioner % Milton M. Bernard, Samuel A. McCain, Attorney for Petitioner.

Harry J. Rudick, Of Counsel.

Dated: New York, New York, September 9, 1954.

[fol. 316] IN UNITED STATES COURT OF APPEALS

CORN PRODUCTS REFINING COMPANY, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

Before Chase, Hincks and Harlan, Circuit Judges

Jay O. Kramer, Samuel A. McCain, Attorneys for Petitioner, Milton M. Bernard, Harry J. Rudick, of Counsel.

Filed September 27, 1954

Per CURIAM:

Petition for rehearing denied.

[fol. 317] [File endorsement omitted.]

[fol. 318] In United States Court of Appeals, Second Circuit

Corn Products Refining Company, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

Corn Products Refining Company, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

Order Denying Rehearing—Filed September 27, 1954

A petition for a rehearing having been filed herein by counsel for Corn Products Refining Company,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

(S.) A. Daniel Fusaro, Clerk.

[fol. 319] [File endorsement omitted.]

[fol. 320] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 321] Supreme Court of the United States, October Term, 1954

No. 457

[Title omitted]

Order Allowing Certiorari—Filed January 10, 1955

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted limited to questions 1 and 2 presented in the petition for certiorari which read as follows:

"1. Are transactions in commodity futures which are not 'true hedges' capital asset transactions and thus subject to the limitations of § 117 of the Internal Revenue Code of

1939, or do the resulting gains and losses from such transactions give rise to ordinary income and ordinary deductions? (1940) (1942)

"2. Are commodity futures contracts 'securities' and thus subject to the 'wash sales' provisions of § 118 of the Internal Revenue Code of 1939? (1940) (1942)"

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(3400)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. [redacted] 90

CORN PRODUCTS REFINING COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

SAMUEL A. McCAIN,
17 Battery Place,
New York 4, New York,

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Counsel for Petitioner.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No.

CORN PRODUCTS REFINING COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Corn Products Refining Company prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above entitled consolidated cases on the 25th day of August, 1954. A petition for rehearing was denied September 27, 1954.

Citation to Opinions Below

The two opinions of The Tax Court in these consolidated proceedings involve Federal income taxes for the calendar year 1940 and Federal income and excess profits taxes for the calendar year 1942, and the composition of the excess profits credit for such years based on income. The opinion for the year 1940 appears in 16 T. C. 395 and printed in Appendix B hereof, *infra*, page 52.

The Memorandum opinion of The Tax Court, dated June 30, 1952, involving the calendar year 1942 is also printed in Appendix B hereof, *infra*, page 33.

The opinion of the United States Court of Appeals is printed in Appendix B hereof, *infra*, page 48, and is reported in 215 F. (2d) 513.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered on August 25, 1954. Rehearing was denied on September 27, 1954. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1). A single writ of certiorari is sought in the consolidated cases under Rule 23(5) of the Rules of this Court.

Questions Presented

Four separate and distinct questions are presented for review. The tax year involved is indicated in connection with each question.

I

Commodity Futures Transactions

Are transactions in commodity futures which are not "true hedges" capital asset transactions and thus subject to the limitations of Section 117 of the Internal Revenue Code of 1939, or do the resulting gains and losses from such transactions give rise to ordinary income and ordinary deductions? (1940) (1942)

II

Wash Sales

Are commodity futures contracts "securities" and thus subject to the "wash sales" provisions of Section 118 of the Internal Revenue Code of 1939? (1940) (1942)

III

Foreign Dividends

Where parts of foreign dividends, subject to foreign government currency control restrictions, were converted to dollars, does the remainder which was actually used in the foreign country constitute taxable income? (1942)

IV

Jurisdiction of This Court and of the Court of Appeals

Does Section 732(c) of the Internal Revenue Code o 1939 take away the jurisdiction of the Appellate Courts to review Tax Court decisions under Section 710(c) of the Internal Revenue Code of 1939 relating to carry-overs of unused excess profits credits where such carry-overs are affected by income previously determined for 1941 and stipulated herein to be "abnormal" under Section 721 of said Code? (1942)

Statutes Involved

The statutory provisions involved are as follows:

With respect to question I, Section 117 of the Internal Code of 1939;

With respect to question II, Section 118 of the Internal Revenue Code of 1939;

With respect to question IV, Sections 710, 721, and 732(c) of the Internal Revenue Code of 1939.

They are printed in Appendix A, *infra*, pages 17-24.

Statement

The basis of the jurisdiction of the court of first instance, The Tax Court of the United States, was in each case, a petition filed by the taxpayer pursuant to Section 272 of the Internal Revenue Code of 1939.

The case with respect to each of the questions presented is as follows:

I

Commodity Futures Transactions

Petitioner's contention is that the commodity futures transactions were capital asset transactions since they were not "true hedges".

The Court of Appeals held that even though the transactions were not "true hedges", they gave rise to ordinary income and ordinary losses.

The facts pertaining to this question are as follows:

Petitioner is a nationally-known corporation engaged in the manufacture and sale of products derived from corn (R. 66, 606). Its own plants could store 2,303,000 bushels or less than three weeks' supply of corn (R. 67, 607). In 1937, as a result of losses previously sustained due to drought, a plan was envisaged whereby petitioner would buy corn futures whenever it considered the price of corn low, with the purpose of establishing a long futures position in the neighborhood of 12,000,000 bushels (R. 70). This position was never attained (R. 70), although substantial quantities of corn futures were acquired (R. 71). In 1939, the outbreak of the European War made this plan unnecessary (R. 71).

The corn futures contracts were not sold to customers in the regular course of petitioner's business but were disposed of, with minor exceptions, through brokers on regulated exchanges; nor were such contracts included in inventory, nor were they subject to depreciation (R. 272, 612).

Under petitioner's general sales policy, contracts were entered into with its customers for shipment within thirty days (R. 607-608). The price was named but provision was made that if the price in effect on the day of delivery was lower the buyer was to have the advantage of such lower price (R. 607-608). This made a true hedge mathematically impossible. Petitioner also had the policy of permitting its customers to cancel their orders in their discretion (R. 608). Cancellations were frequent and unpredictable (R. 75, 207). This made any balancing of customers orders against purchases of futures contracts impossible. Petitioner was not protected against price declines as it would have been under a "true hedge".

II

Wash Sales

Petitioner contends that its corn futures transactions were subject to the wash sales provisions of Section 118 of the Internal Revenue Code of 1939. The Court of Appeals held that they were not.

The facts pertaining to this question are as follows:

A corn future consists of a contract to deliver 5,000 bushels of corn, or some multiple thereof, of a stated quality, at a stated price, for delivery during a stated month in the future (R. 68, 610). Such contracts called for delivery within eleven months or less from the date of contract (R. 68, 610). Such contracts are freely dealt with on regulated commodity exchanges through brokers (R.

69). The buyer of a futures contract furnishes his broker with margin (R. 69). These contracts were acquired and disposed of, with minor exceptions, through brokers on regulated exchanges in the same manner that stocks and bonds were dealt in on the same exchanges (R. 272 and 280).

III

Foreign Dividends

Petitioner contends that it had reportable income from Italian and Brazilian dividends during the year 1939. The result of such treatment would increase its excess profit credit and its unused excess profit credits carry-overs.

The facts pertaining to this question are as follows:

During 1939, petitioner had certain subsidiaries in Brazil and Italy (R. 618 and 621). In December, 1938, Maizena, Brazil, S. A., a wholly-owned subsidiary, declared a dividend in the amount of 2,175,000$000 Brazilian milreis, which was paid on January 13, 1939 (R. 619). Petitioner actually received the dollar equivalent in the United States of 100,649$900 milreis in 1939 (R. 621). Petitioner lent the balance of the dividend paid by Maizena, to another wholly-owned subsidiary operating in Brazil, Refinacoes de Milho, Brazil, a New Jersey corporation (R. 750, 769, 770).

In 1939, various Italian corporations declared and paid dividends in the sum of 4,496,327 lire to petitioner, a stockholder thereof (R. 622-623). During the year 1939, petitioner actually converted 410,000 lire of dividend income to dollars at 2.1¢ per lira (R. 624). Upon the payments of dividends the monies were either deposited in Italian bank accounts at interest to the credit of petitioner (R. 765-766) or were loaned to other Italian subsidiaries of petitioner for use by them (R. 759).

The Court of Appeals decided in favor of the Government that the dividends were not taxable income, stating that the petitioner had not sustained the burden of "proof of free convertibility".

IV

Jurisdiction of This Court and of the Court of Appeals

Petitioner contends that the Court of Appeals has jurisdiction to review the determination of The ~~Tax~~ Court with respect to an unused excess profits credit carry-over computed under Section 710(c) of the Internal Revenue Code and that nothing under Section 732(c) deprives the Court of that jurisdiction. The Court of Appeals held that it lacked jurisdiction.

The facts pertaining to this question are as follows:

In the year 1941 petitioner had no excess profits tax liability (R. 676). It did, however, have $436,945.36 of conceded abnormal income in that year attributable under Section 721 to pre-excess profits tax years (R. 630, 675). Respondent in computing the unused excess profits credit carry-over under Section 710(c) from 1941 to 1942 refused to exclude the amount of the 1941 abnormal income, *i. e.*, $436,945.36 from petitioner's 1941 excess profits net income. As a consequence the unused excess profits credit carry-over from 1941 was not increased by that amount (R. 630).

Reasons for Granting the Writ

I. On the Question Whether the Petitioner's Transactions in Commodity Futures Contracts Gave Rise to Capital or Ordinary Gains and Losses

A. There Is a Conflict Among Circuits.

The decision of the Court of Appeals to the effect that petitioner's transactions in corn futures gave rise to ordi-

nary income and deductions is in direct conflict with decisions of three other Courts of Appeals. *Estate of Dorothy Makransky et al.* v. *Commissioner* (3rd Cir.—1946), 154 F. (2d) 59, affirming 5 T. C. 397; *Commissioner* v. *Farmers & Ginners Cotton Oil Co.* (5th Cir.—1941), 120 F. (2d) 772, reversing B. T. A. Memo., Docket No. 93436 (March 3, 1942); *Trenton Cotton Oil Co.* v. *Commissioner* (6th Cir.—1945), 147 F. (2d) 33, reversing T. C. Memo., Docket No. 110950 (December 28, 1943); all of which decisions are printed in Appendix C, page 57 and *ff.*

In the *Makransky* case, the taxpapers, wool converters, fearing a shortage of wool because of the impact of World War II, purchased wool top futures contracts equivalent to approximately three quarters of their estimated annual requirements in an attempt to assure themselves of a supply. Losses on the subsequent sales of these futures contracts were held to be capital losses.

The other two cases cited involved similar fact patterns, and the decisions were to the same effect.

The Court of Appeals in the instant case was not unaware of the above cited cases. Indeed, it referred to them directly. It noted the inconsistency between the position of the Commissioner of Internal Revenue in those cases and in the instant case, saying (p. 1791):

> "However, from 1940 to 1946 the Commissioner successfully contended in a series of instances [citing the cases above mentioned] that dealings in commodity futures contracts gave rise to capital rather than ordinary gains and losses . . ."

The Court, however, made no attempt whatsoever to distinguish them. It is submitted that the instant case cannot be distinguished.

The decisions in each of the three cited cases turned on the finding that the taxpayer's commodity futures trans-

actions did not constitute a "true hedge". In the instant case, the Court of Appeals specifically stated that the petitioner's commodity futures transactions did not constitute a "true hedge", saying (p. 1794):

> "The future transactions of this petitioner it is true did not constitute what is known as 'true' hedging. The true hedge can occur only when forward sales prices are fixed and the relation between commodity purchase and later sales price is insured against both increase and decrease of commodity prices. As the forward sales prices here were based mainly on the lower of order or market prices, the petitioner was protected only against increases in commodity prices and did not have the complete insurance of the true hedge."

Contrary to the rationale of the three cited cases, however, the Court in the instant case came to the completely opposite decision.

The three cases cited above and the instant case contain the following salient elements in common:

(1) All cases involved commodity futures transactions.

(2) In all cases the transactions were an integral part of the way of doing business of the taxpayer.

(3) In all cases the transactions were entered into with a view to protecting the ordinary profits of the taxpayer.

(4) In all cases the Courts found that there was not a "true hedge", *i. e.*, no balanced position and no protection against price declines.

In the three cited cases the transactions of the taxpayers were treated as capital asset transactions. In the instant case the transactions of the petitioner were treated as ordinary transactions. The conflict between the Circuits should be resolved, so that application of the law

will be uniform throughout the United States as required by Article I, Section 8, Clause 1 of the Constitution, and so that the inconsistent positions taken by the respondent will be eliminated for the future.

B. An Important Question of Federal Law Not Heretofore Decided by This Court Is Involved.

Although the instant case arose under the Internal Revenue Code of 1939, the question still remains of continuing importance under the Internal Revenue Code of 1954 (Section 1233).

Moreover, the prevalence and vast dollar volume of commodity futures trading on regulated exchanges in the United States is well known.* As a consequence, a decision on the question involved is one that will have an important impact on both taxpayers and the revenue of the United States.

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* *Statistical Abstract of the United States* — 1953, page 459.

No. 509.—Principal Commodity Futures—Volume of Trading on All Contract Markets: 1940-41 to 1951-52

(Compiled from daily reports of all clearing members of each contract market)

Year Beginning July	Wheat (million bushels)	Corn (million bushels)	Oats (million bushels)	Rye (million bushels)	Soybeans (million bushels)	Cotton (thousand bales)	Eggs (carlots)
1940-41	4,783.9	795.8	248.5	266.2	611.4	34,258	46,903
1941-42	3,831.0	1,235.6	524.0	790.0	681.6	64,903	41,975
1942-43	2,703.2	851.3	610.6	1,469.7	16.0	42,738	9,005
1943-44	2,641.7	(1)	726.4	3,031.1	(1)	39,170	6,085
1944-45	2,425.0	491.3	1,090.2	3,978.6	(1)	37,813	40,729
1945-46	1,474.0	117.6	2,438.8	1,963.5	(1)	60,353	79,357
1946-47	2,322.4	2,608.9	3,905.6	.2	(1)	110,248	135,325
1947-48	5,768.1	3,798.8	2,668.6	21.1	40.2	110,583	125,020
1948-49	4,514.9	3,678.3	1,175.7	125.4	1,537.7	63,385	91,191
1949-50	4,202.0	2,013.4	1,048.2	581.6	3,613.9	52,697	56,938
1950-51	4,675.7	2,236.6	1,617.3	576.2	2,952.6	79,067	148,811
1951-52	4,341.7	2,639.6	2,239.2	426.6	2,953.2	94,887	90,005

1 Trading suspended.

Source: Deparment of Agriculture, Commodity Exchange Authority; annual report, *Commodity Futures Statistics*.

II. On the Question Whether Commodity Futures Contracts Are Securities and So Subject to the Wash Sales Provisions of Section 118 of the Internal Revenue Code of 1939

A. There Is a Conflict Between Circuits.

The decision of the Court of Appeals in the instant case, in direct conflict with *Trenton Cotton Oil Co.* v. *Commissioner* (6th Cir.—1945), 147 F. (2d) 33, held that commodity futures were not securities and consequently that transactions in them were *not* subject to the wash sales provisions of Section 118 of the Internal Revenue Code of 1939. In *Trenton Cotton Oil Co.* v. *Commissioner, supra*, the Sixth Circuit had held that commodity futures were securities and consequently that transactions in them *were* subject to the wash sales provisions.

This conflict between the Circuits was expressly recognized by the Court below in its opinion (Appendix B, *infra*, p. 53), where it stated:

> "The petitioner's further contention that the wash sales provision of Section 118 is applicable to its futures transactions rests on *Trenton Cotton Oil Co.* v. *Commissioner* (6th Cir.—1945) 147 F. (2d) 33, rehearing denied 148 F. (2d) 208. With deference, however, we find ourselves unable to agree with that decision. *Cf. Harriss* v. *Commissioner* 2nd Cir., 143 F. (2d) 279; *Valley Waste Mills* 5th Cir., 115 F. (2d) 466, cert. denied 312 U. S. 681."

The conflict between the Circuits should be resolved so that the application of the law will be uniform throughout the United States as required by Article I, Section 8, Clause 1 of the Constitution.

B. An Important Question of Federal Law Not Heretofore Decided by This Court Is Involved.

The importance of this question was recognized by the Court of Appeals in *Trenton Cotton Oil Co.* v. *Commissioner, supra* (p. 37), when it used the following language:

> "The sole purpose of the statute was to prevent the deduction of losses from net income and the Congress set up as a barrier a more or less arbitrary standard to overcome the evil. Unless losses from dealings in commodity futures through a broker are within the statute, the barrier is weakened, because the dealings in such property on exchanges of the country are almost as extensive as that in stocks and bonds."

Although the instant case arose under the Internal Revenue Code of 1939, the question still remains of importance under the Internal Revenue Code of 1954 (Section 1091).

Moreover, the prevalence and vast dollar volume of commodity futures trading in the United States (see statistical material, p. 10, *supra*) makes a decision on the question involved one of very real importance to both taxpayers and the revenue of the United States.

III. On the Question Whether the Petitioner Had Income from Foreign Dividends

The decision of the court below in the instant case is in apparent conflict with the decision of the Third Circuit in *Richard Whitney* v. *Commissioner* (3rd Cir.—1934), 73 F. (2d) 589.

In the instant case the taxpayer urged that it had income from foreign dividends in 1939. It showed that the dividends were declared and paid in a foreign currency,

that it was able to and did convert a portion of its Brazilian and Italian funds at a price, and it actually used the balance for corporate purposes in the foreign countries. The court below held in respect of the balance of the dividends actually used abroad for corporate purposes that the taxpayer did not have income, refusing to recognize upon this showing that the burden of going forward with proof that the taxpayer did not have income in 1939 shifted from the taxpayer to the Commissioner. Respondent offered no proof whatever on this issue.

In the *Whitney* case, *supra*, the Third Circuit recognized that once petitioner had come forward with proof to establish its contention, the burden of going forward shifted to the respondent. It is believed that the decision of the court below in failing to recognize this rule of law is erroneous and creates a conflict. The question is one of broad application in the trial of Tax Court cases.

IV. On the Question of the Jurisdiction of This Court and the Court of Appeals

A. There Is a Conflict Among Circuits.

The decision of the Court below that it did not have jurisdiction because of Section 732(c) to determine under Section 710(c) the carry-over of unused excess profits credit is in conflict with the decisions of three Courts of Appeals, *Stimson Mill Company* v. *Commissioner* (9th Cir.—1947), 163 F. (2d) 269; *Dowd-Feder, Inc.* v. *Commissioner* (6th Cir.—1949), 173 F. (2d) 673, and *Packer Publishing Co.* v. *Commissioner* (8th Cir.—1954), 211 F. (2d) 612. The three Circuit Court decisions cited above have all permitted taxpayers to appeal to the Circuit Court in cases involving excess profits issues where the question does not arise *solely* by reason of Section 711, Section 721, or Section 722.

The Court below held that it had no jurisdiction to consider the effect of petitioner's abnormal income realized in 1941 on its unused excess profits credit carry-over from the same year. While it is true that the jurisdiction of The Tax Court is final in cases arising *solely* by reason of Section 721, the issue in the instant case concerns itself, not *solely* with Section 721, but with Section 710(c).

The Court below has overlooked, in interpreting the statute, the word "solely". If a decision involves only Section 721 or Section 722, the Court of Appeals has no jurisdiction to review The Tax Court. *George Kemp Real Estate Company* v. *Commissioner* (2nd Cir.—1950), 182 F. (2d) 1947; *James E. Waters, Inc.* v. *Commissioner* (9th Cir.—1947), 160 F. (2d) 596. Consequently, where the question before the Court, as in the present case, does not challenge the Commissioner's determination with respect to Section 721 since the net abnormal income was conceded, the question cannot arise solely by reason of that section within the meaning of Section 732(c). The only question actually before the Court was the computation of the correct carry-over of unused excess profits credit, and that question is determined by Section 710(c).

The petitioner in 1941 had received $436,945.36 of abnormal income within the meaning of Section 721. This is conceded by the Commissioner and is nowise in question in this case. The question at issue is the proper treatment of this abnormal income for purposes of computing petitioner's unused excess profits credit carry-over. This is to be determined under Section 710(c) and not under Section 721, which latter Section does not deal with credit carry-overs.

B. An Important Question of Federal Law Not Heretofore Decided by This Court Is Involved.

This question is one of importance because of the large volume of excess profits relief claims still pending

both before the Treasury and before The Tax Court of the United States, and the conflict of decisions accordingly should be resolved so that the application of the statute will be uniform throughout the United States as required by Article I, Section 8, Clause 1 of the Constitution.

CONCLUSION

For the foregoing reasons this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

SAMUEL A. McCAIN,
HARRY J. RUDICK,
JAY O. KRAMER,
Counsel for Petitioner.

Dated: November 19, 1954.

APPENDIX A

Internal Revenue Code of 1939

"SEC. 117. CAPITAL GAINS AND LOSSES.

"(a) *Definitions.*—As used in this chapter—

"(1) *Capital Assets.*—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

"(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

"(B) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), • • •

• • • •".

"SEC. 118. LOSS FROM WASH SALES OF STOCK OR SECURITIES.

"(a) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 23(e) (2); nor shall such deduction be allowed under section 23(f) unless the claim is made by a corporation, a dealer in stocks or

securities, and with respect to a transaction made in the ordinary course of its business.

* * * *"

"SEC. 710. IMPOSITION OF TAX.

* * * *

"(c) Unused Excess Profits Credit Adjustment.—

"(1) *Computation of Unused Excess Profits Credit Adjustment.*—The unused excess profits credit adjustment for any taxable year shall be the aggregate of the unused excess profits credit carry-overs and unused excess profits credit carry-backs to such taxable year.

"(2) *Definition of Unused Excess Profits Credit.*—The term 'unused excess profits credit' means the excess, if any, of the excess profits credit for any taxable year beginning after December 31, 1939, over the excess profits net income for such taxable year, computed on the basis of the excess profits credit applicable to such taxable year. For such purpose the excess profits credit and the excess profits net income for any taxable year beginning in 1940 shall be computed under the law applicable to taxable years beginning in 1941. * * *"

"SEC. 721. ABNORMALITIES IN INCOME IN TAXABLE PERIOD.

"(a) *Definitions.*—For the purpose of this section—

"(1) *Abnormal Income.*—The term 'abnormal income' means income of any class includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the

amount of such income of such class includible in the gross income of the taxable year is in excess of 125 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

"(2) *Separate Classes of Income.*—Each of the following subparagraphs shall be held to describe a separate class of income:

"(A) Income arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

* * * *

"(C) Income resulting from exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing, extending over a period of more than 12 months; or

"(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's accounting period or method of accounting; or

"(E) In the case of a lessor of real property, income included in gross income for the taxable year by reason of the termination of the lease; or

"(F) Income consisting of dividends on stock of foreign corporations, except foreign personal holding companies.

All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in

subparagraphs (A) to (F), inclusive, shall be subject to regulations prescribed by the Commissioner with the approval of the Secretary.

"(3) *Net Abnormal Income.*—The term 'net abnormal income' means the amount of the abnormal income less, under regulations prescribed by the Commissioner with the approval of the Secretary, (A) 125 per centum of the average amount of the gross income of the same class determined under paragraph (1), and (B) an amount which bears the same ratio to the amount of any direct costs or expenses, deductible in determining the normal-tax net income of the taxable year, through the expenditure of which such abnormal income was in whole or in part derived as the excess of the amount of such abnormal income over 125 per centum of such average amount bears to the amount of such abnormal income.

"(b) *Amount Attributable to Other Years.*—The amount of the net abnormal income that is attributable to any previous or future taxable year or years shall be determined under regulations prescribed by the Commissioner with the approval of the Secretary. In the case of amounts otherwise attributable to future taxable years, if the taxpayer either transfers substantially all its properties or distributes any property in complete liquidation, then there shall be attributable to the first taxable year in which such transfer or distribution occurs (or if such year is previous to the taxable year in which the abnormal income is includible in gross income, to such latter taxable year) all amounts so attributable to future taxable years not included in the gross income of a previous taxable year.

"(c) *Computation of Tax for Current Taxable Year.*—The tax under this subchapter for the taxable year, in

which the whole of such abnormal income would without regard to this section be includible, shall not exceed the sum of:

"(1) The tax under this subchapter for such taxable year computed without the inclusion in gross income of the portion of the net abnormal income which is attributable to any other taxable year, and

"(2) The aggregate of the increase in the tax under this subchapter for the taxable year (computed under paragraph (1)) and for each previous taxable year which would have resulted if, for each previous taxable year to which any portion of such net abnormal income is attributable, an amount equal to such portion had been included in the gross income for such previous taxable year.

"(d) *Computation of Tax for Future Taxable Year.*— The amount of the net abnormal income attributable to any future taxable year shall, for the purposes of this subchapter, be included in the gross income for such taxable year:

"(1) The tax under this subchapter for such future taxable year shall not exceed the sum of—

"(A) the tax under this subchapter for such future taxable year computed without the inclusion in gross income of the portion of such net abnormal income which is attributable to such year, and

"(B) the decrease in the tax under this subchapter for the previous taxable year in which the whole of such abnormal income would, without regard to this section, be includible which resulted by reason of the computation of such tax for such previous taxable year under the provisions of subsection (c); but the amount of such decrease shall

be diminished by the aggregate of the increases in the tax under this subchapter for the future taxable year as computed under subparagraph (A) and for the taxable years intervening between such previous taxable year and such future taxable year which have resulted because of the inclusion of the portions of such net abnormal income attributable to such intervening years in the gross income for such intervening years.

"(2) If, in the application of subsection (c), net abnormal income from more than one taxable year is attributable to any future taxable year, paragraph (1) of this subsection shall be applied with respect to such future taxable year in the order of the taxable years from which the net abnormal income is attributable beginning with the earliest, as if the portion of the net abnormal income from each such year was the only amount so attributable to such future taxable year, and (except in the case of the portion for the earliest previous taxable year) as if the tax under this subchapter for the future taxable year was the tax determined under paragraph (1) with respect to the portion for the next earlier previous taxable year.

"(3) If in the application of paragraph (1) to any future taxable year it is determined that the decrease in tax computed under paragraph (1) (B) with respect to the net abnormal income, a portion of which is included in the gross income for the future taxable year, does not exceed the aggregate of the increases in tax computed under paragraph (1) (B) with respect to such net abnormal income, then the portions of such net abnormal income attributable to taxable years subsequent to such future taxable year shall not be included in the gross income for such subsequent taxable years. For the purpose of computing

the tax under this subchapter for a taxable year subsequent to the future taxable year, the portion of net abnormal income attributable to the future taxable year shall not be included in the gross income for such future taxable year to the extent that the inclusion of such portion of net abnormal income in the gross income for such future taxable year did not result in an increase in tax for such future taxable year by reason of the provisions of paragraph (1).

"(e) *Application of Section.*—This section shall be applied only for the purpose of computing the tax under this subchapter as provided in subsections (c) and (d), and shall have no effect upon the computation of base period net income. For the purposes of subsections (c) and (d)—

"(1) Net abnormal income means the aggregate of the net abnormal income of all classes for one taxable year.

"(2) Under regulations prescribed by the Commissioner with the approval of the Secretary, the tax under this subchapter for previous taxable years shall be computed as if the portions of net abnormal income for each previous taxable year for which the tax was computed under this section were included in the gross income for the other previous taxable years to which such portions were attributable.

"(3) If both subsections (c) and (d) are applicable to any current taxable year, subsection (d) shall be applied without regard to subsection (c), and subsection (c) shall be applied as if the tax under this subchapter, except for subsection (c), was the tax computed under subsection (d) and as if the gross income and the other amounts necessary to determine the adjusted excess profits net income were those

amounts which would result in the tax computed under subsection (d).

"(f) *Abnormal Income From Exploration, Etc.*—If by reason of taking into account, in determining constructive average base period net income under section 722, exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing, extending over a period of more than 12 months, such constructive average base period net income is higher than it would be without such taking into account, only such portion of the income in the taxable year resulting from such activity which is of a class described in subsection (a) (2) (C) as is attributable to another taxable year under this subchapter shall be deemed attributable to a year other than the taxable year."

"SEC. 732. REVIEW OF ABNORMALITIES BY BOARD OF TAX APPEALS [NOW THE TAX COURT OF THE UNITED STATES].

* * * *

"(c) *Finality of Determination.*—If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Board.

* * * *"

APPENDIX B

CORN PRODUCTS REFINING CO., PETITIONER, v. COMMISSIONER OF INTERNAL REVENUE

Docket No. 20399. February 20, 1951.

WASH SALES — SECURITIES — SUBSTANTIALLY IDENTICAL — COMMODITY FUTURES — SECTION 118.—Contracts for the delivery of corn for a stated price at a stated future time are not securities within the meaning of section 118 and one such contract is not substantially identical with another where the date for delivery is different and the contract price and the other contracting party may be different.

Jay O. Kramer, Esq., for the petitioner.

Walt Mandry, Esq., for the respondent.

The Commissioner determined a deficiency of $163,804.78 in the income tax of the petitioner and an affiliate for 1940. The issues in dispute are whether profits and losses of the petitioner resulting from purchases and sales of corn futures are capital gains and losses within the meaning of section 117 and, second, whether the wash sales provisions of section 118 apply to those transactions.

FINDINGS OF FACT.

The petitioner filed a consolidated corporate income tax return for 1940 with the collector of internal revenue for the second district of New York.

The petitioner is a nationally known corporation engaged in the manufacture and sale of corn products, including starches, sugars, syrups, oils, and feeds.

The maximum amount of raw corn which the petitioner could store in its own plants during 1940 was 2,303,000 bushels. That quantity would keep it supplied for less than three weeks. The daily grind capacity of the plants

of the petitioner during 1940 was 147,700 bushels. Similar conditions existed in prior years.

The principal product obtained by the petitioner from raw corn is starch. Cerelose is a refined sugar derived from starch. It competes with cane and beet sugars, but at a lower price, and constituted 15.93 per cent of the total sales of the petitioner in 1940.

A corn future consists of a contract to buy 5,000 bushels of corn, or some multiple thereof, of a stated quality, at a stated price, during a stated month in the future. The contracts involved were for delivery at a stated time within eleven months or less of the date of the contract. The party contracting to furnish the corn has the option of delivering the corn on any day during the month in which the contract matures and has the option of furnishing a different grade of corn at an appropriate adjustment in price. The transactions are made through a broker on a commodity exchange. The buyer furnishes his broker with a percentage, or margin, of the contract price of the corn until delivery is taken or the contract is sold, at which time final settlement is made. The contracts are freely dealt in on the commodity exchange.

The petitioner began to buy and sell corn futures in 1932 and continued that practice through 1940. It engaged in those futures transactions as a part of its corn buying program and as the most economical method of obtaining an adequate supply of [illegible] corn in view of its limited storage facilities and the expense of increasing those facilities sufficiently to take care of its needs. Purchases of futures were made when the price of corn was advantageously low.

High corn costs following droughts in 1934 and 1936 resulted in losses on cerelose sales made by the petitioner in 1937. The petitioner, in order to avoid or minimize similar losses, increased its buying of corn futures so

that it would have corn available at prices which permitted it to sell cerelose in competition with beet and cane sugar. It never reached its goal of a long position of 12,000,000 bushels.

The petitioner took delivery of corn on some of its future contracts, but usually sold most of its corn futures in early summer if it then appeared that there would be no shortage of corn and no great danger of increased prices, but if the crop was poor, or there was danger of an increase in price, it sold its futures gradually as it bought corn for grinding. The petitioner would begin to acquire additional futures contracts at harvest time each year.

The outbreak of World War II in 1939 raised the price of cane and beet sugars to such an extent that the petitioner no longer needed the futures to assist it in selling cerelose successfully in competition with those sugars. It owned futures at the beginning of 1940 for the purchase of over 8,000,000 bushels of corn. That long position was reduced, beginning in about June, so that, at the end of the year, it had futures covering only about 1,400,000 bushels.

It was the petitioner's practice to account for its profits or losses on corn futures in an account entitled "Corn Miscellaneous." The balance in that account, at the end of each year prior to 1940, was debited or credited to cost of sales and in 1940, the profit balance of $680,587.39 was used to reduce "Cost of Goods Sold."

The Commissioner, in determining the deficiency for 1940, made no change in "Cost of Goods Sold" as reported by the petitioner on its return.

The transactions in futures resulted in losses of $816,164.03 for 1938 and of $424,437.54 for 1939, and a net profit of $680,587.39 for 1940.

The following table shows for three years the futures purchased, those sold, and those under which delivery

was taken, together with the amount of corn purchased and received at the plants:

Year	Futures purchased		Futures sold		Futures under which delivery was taken		Bushels of Corn Purchased and Received at the plant
	Contracts	Bushels	Contracts	Bushels	Contracts	Bushels	Bushels
1938	824	19,675,000	755	17,400,000	192	4,975,000	35,650,77
1939	593	14,470,000	535	14,180,000	114	2,865,000	36,806,80
1940	437	8,125,000	728	14,595,000	24	250,000	37,222,40

The general sales policy of the petitioner, at all times material hereto, was to enter into contracts providing for shipment of the goods within thirty days and stating a definite price, but providing that the price should be that stated in the contract or the price in effect at date of delivery, whichever was lower. There were exceptions and variations to this general policy. One was that the petitioner, on January 15, 1940, invited all buyers to submit on or prior to January 20, orders for cerelose to be delivered as late as June 30, 1940. The buyer was guaranteed the lower of the January 15 price or the price in effect at date of delivery. The buyers were allowed to cancel all or parts of the amounts of the goods ordered. The petitioner received a great many orders in response to that invitation. Another exception was that the canning trade on the Pacific Coast was allowed to call on the petitioner for cerelose for delivery in more than thirty days. Cancellations were allowed in this situation also and the buyers were allowed the lower of the contract price or the price in effect at the date of delivery. The petitioner also agreed to furnish starch to two companies on what was, in effect, a cost plus basis.

The stipulation of facts is incorporated herein by this reference.

Appendix B

OPINION.

Murdock, *Judge:*

The parties have argued two points. One is whether contracts for the future delivery of corn are to be treated as capital assets in the hands of the petitioner so that gains or losses thereon are capital gains or losses, and the other is whether the wash sales provisions of section 118 apply to those transactions. The petitioner has not accounted for or reported its gains and losses from futures transactions as capital gains and losses but, on the contrary, treated the 1940 gains as a reduction in the cost of raw materials and the losses in prior years as an addition to the cost of goods sold. It thus reduced its income for prior years by the full amount of large losses sustained in those years on futures transactions and, being consistent, in 1940 reduced the cost of goods sold by the full amount of the 1940 gain. The Commissioner, in determining the deficiency, made no change in the taxpayer's treatment of the futures transactions and now insists that no change is necessary or proper. Nevertheless, the petitioner now seeks to have the transactions regarded as resulting in capital gains and losses within section 117.

Success on that point would have no effect on the tax liability in this case unless the second contention of the petitioner is also sustained. The petitioner sustained a short term capital loss of $5,718.27 on bonds and it did not show any short term capital gains on its return against which to offset that loss. However, the Commissioner, in determining the deficiency, held that there were short term capital gains of $28,260.71 on foreign exchange and allowed the short term capital losses to be deducted in full. His action in this respect is not challenged in this proceeding. The tax is the same whether the $680,587.39

reduces cost of goods sold or is taxed as a short-term capital gain. Thus, it is not necessary to decide in this case whether or not section 117 applies to the futures transactions unless it is held that section 118 also applies. The question of whether transactions in commodity futures are within section 117 is a difficult one as is shown by prior decisions cited by the parties. While there would seem to be logic and common sense in the position which the Commissioner now takes and which the petitioner has always taken in accounting for these transactions, nevertheless, the Court expresses no opinion on that subject at the present time.

Section 118 of the Internal Revenue Code was enacted to prevent a deduction for losses sustained in wash sales of securities; that is, where the taxpayer at or about the time of a sale acquires identical or substantially identical securities. The deduction is postponed until the securities are disposed of and not replaced within 30 days. It provides that no deduction for loss shall be allowed under section 23(f), with exceptions not here material, if the loss is claimed to have been sustained from any sale "of shares of stock or securities" where within 30 days before or after the sale the taxpayer has acquired "substantially identical stock or securities." Other provisions are to the effect that the basis and the holding period of the securities sold attach to the securities purchased where the wash sale provision has applied. The petitioner, by tracing its loss transactions of prior years and assuming that a number of those transactions were wash sales within the meaning of section 118, arrives at bases for the futures sold in 1940 which would show capital gains of $62,328.10 and capital losses of $202,662.60 instead of the gain of $680,587.39 which it reported in accordance with its consistent method of accounting. It relies on *Treaton Cotton Oil Company* v. *Commissioner*, 147 Fed. (2d) 33, rehear-

ing denied, 140 Fed. (2d) 208, reversing on this point a memorandum opinion of this Court.

We are unable to agree with the opinion in the cited case holding that the words "stocks and securities," as used in section 118, include commodity futures and that a new future contract is "substantially identical" with a prior contract. The Appellate Court reasoned that the futures contracts were securities because they were pledged with the broker "who advanced the necessary funds to purchase the oil." Any pledged property is a security in that sense, but obviously not all pledged property is a security within the meaning of section 118. Furthermore, the reasoning is unsound since the broker does not advance the funds necessary to purchase the commodity. The buyer of a commodity futures contract puts up a margin with his broker which is a percentage of the purchase price called for in the contract. That margin is held as security until the contract is closed out. If the purchaser of the contract takes delivery of the corn, he then pays the additional amount called for under the contract, but if he sells the contract he gets credit for the margin which he put up with his broker, plus the price at which the broker sold the contract, and neither he nor the broker makes any further payment on account of the purchase price which that particular purchaser owed under the contract. The Appellate Court also reasoned that the futures contract was "a security" because "the petitioner had no more than a document giving it the right to demand and receive property not in its possession." The owner of a commodity future has no right to demand the property except at maturity upon payment of the contract price. All executory contracts giving a person the right to demand and receive property upon the payment of a contract price are not to be regarded as securities within the meaning of section 118.

Furthermore, a new future commodity contract is not "substantially identical" with any prior contract even though the quantity involved in each is identical. It would be purely accidental if the new contract was with the same party as the one who had agreed to sell the commodity in the earlier contract. The price would probably be different and the delivery date would certainly be different. The United States District Court, Middle District of Georgia, on April 11, 1940, in the case of *Valley Waste Mills* v. *Page*, 27 A.F.T.R. 957, held, in regard to cotton futures, that the new contract was not "substantially identical" with the old one under such circumstances and, with that, we agree. Cf. section 117(d)(3)(B) as added by section 211, Revenue Act of 1950. Cotton futures were considered by the Circuit Court of Appeals for the Fifth Circuit in *Valley Waste Mills* v. *Page*, 115 Fed. (2d) 466; certiorari denied, 312 U.S. 681, and it is apparent from the opinion there that such a future is not a security in any generally recognized sense but simply a contract between two parties in which one agrees to supply at a designated time in the future a stated quantity and quality of goods, upon payment of a stated price and on which a part of the contract price, called a margin, has been paid by the buyer to his broker to bind him until the sale is consummated or the contract is sold. See also *Rosenthal* v. *Brown*, 247 N.Y. 479, 160 N.E. 921. Cf. *Pinellas Ice & Cold Storage Co.* v. *Commissioner*, 287 U.S. 462; *Commissioner* v. *Segall*, 114 Fed. (2d) 706; *Commissioner* v. *Nisto Financial Corporation*, 139 Fed. (2d) 253. Corn futures are not different in this respect from cotton futures. Furthermore, corn futures, such as are here involved, are for such short periods and are of such a peculiar character that they do not lend themselves to the evil which section 118 was intended to prevent. Sales of such contracts are completed transactions when made, the gain or loss is recognized at that time, and there is no postpone-

ment of the gain or loss for tax purposes. *Valley Waste Mills v. Page, supra; Robert M. Harriss*, 44 B.T.A. 999, affirmed, 143 Fed. (2d) 279. Section 118 has no application in this case.

The parties have stipulated that certain adjustments are to be made in computing the tax liability of the petitioner.

Decision will be entered under Rule 50.

CORN PRODUCTS REFINING CO., PETITIONER, v. COMMISSIONER OF INTERNAL REVENUE

Docket No. 22074, June 30, 1952.

Jay O. Kramer, Esq., and Samuel A. McCain, Esq., for the petitioner.

Walt Mandry, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

Opper, *Judge:*

Respondent determined deficiencies for the year 1942 in excess profits tax and declared value excess profits tax of $1,520,519.39 and $14,487.94, respectively. Petitioner does not contest certain adjustments. The issues remaining are:

1(a). Whether the profits and losses sustained by petitioner in the years 1939 to 1942, inclusive, on the purchase and sale of corn futures constituted capital gains and losses under section 117, and thus a proper elimination from base period losses for excess profits tax purposes.

1(b). Whether losses sustained by petitioner from transactions in corn futures are subject to the wash sales provisions of section 118.

1(c). If the answer to 1(a) is in the negative, whether the net loss on corn futures transactions sustained by petitioner in the base period year 1939 constituted an abnormal deduction under section 711(b)(1)(J)(ii).

2. Whether dividends declared by foreign corporations payable to petitioner in foreign currency in the base period year 1939 were so blocked by foreign exchange restrictions as not to constitute taxable income in that year.

3. Whether sums paid out as "salaries" and included as part of cost of sales are deductible, although in a later year it was discovered that the amounts had been embezzled and reimbursement from insurance was subsequently received.

4. Whether, in computing petitioner's unused excess profits credit carry-over from 1941 to 1942, the provisions of section 721 apply so as to exclude 1941 abnormal income from excess profits net income of that year, even though petitioner had no excess profits tax liability for 1941.

Some of the facts have been stipulated. The record in Corn Products Refining Co., 16 T. C. 395, has been incorporated by agreement as evidence in this proceeding.

Findings of Fact.

The stipulated facts in this proceeding, and the findings of fact in Corn Products Refining Co., 16 T. C. 395, are hereby found accordingly.

Petitioner is a New Jersey corporation with its prin-

cipal office in New York City. It filed its 1942 return with the collector of internal revenue for the second district of New York.

Issue 1

Petitioner is engaged in the manufacture and sale of corn products, including starches, sugar, syrups, oils and feeds. The principal product obtained by petitioner from raw corn is starch. Cerelose, which is one of petitioner's major products, is a refined sugar derived from starch which competes with cane and beet sugar. Petitioner's plants have a daily grind capacity of 170,000 bushels, and its raw corn storage capacity of 2,303,000 bushels enables it to keep on hand somewhat less than a three-weeks' supply. In the years 1938 to 1942, inclusive, petitioner made purchases of raw corn aggregating 35,650,773, 36,806,869, 37,222,409, 54,079,173, and 60,761,513 bushels, respectively.

Petitioner's sales policy has been to contract for shipments within 30 days at a specified tentative price, with the understanding that the final price shall be the contract price or market price at date of delivery, whichever is lower. When a customer refuses to accept delivery of cerelose or feed, it has been petitioner's practice to cancel the unexecuted portion of the order.

Petitioner's general sales policy of contracting for 30-day shipments has had exceptions and variations, including the following: In 1927, petitioner entered into a contract with the Huron Milling Company, and in 1932 it entered into a contract with the Keever Starch Company, under both of which contracts petitioner was required to manufacture and deliver large quantities of starch for a period of 15 years, the price in both contracts being dependent upon a number of factors, including the price of corn and labor. The Huron contract was modi-

fied on June 1, 1942, and extended for an additional 10 years. In May 1939 petitioner entered into a contract with Eastern Milling Co. under which petitioner was required to deliver quantities of feed each month until May 1940, with a guarantee as to price. On January 15, 1940, petitioner invited all buyers to submit on or prior to January 20, orders for cerelose to be delivered as late as June 30, 1940, buyers being guaranteed the lower of the January 15 price or the price in effect at date of delivery, and being allowed to cancel all or part of their orders. Petitioner received many orders in response to that invitation and its sales of cerelose at that time approximated 2,000,000 bags. Members of the canning industry on the Pacific Coast have been permitted to call on petitioner for cerelose for delivery in more than 30 days, with price guarantees and allowance for cancellations.

For a number of years it has been petitioner's custom to purchase and sell corn futures contracts through members of a recognized Commodity Exchange. A corn future is a contract calling for the delivery at a stated time, within eleven months or less, of 5,000 bushels of corn or some multiple thereof, of a stated quality, at a stated price. Petitioner engaged in futures transactions as a part of its corn buying program and as the most economical method of obtaining an adequate supply of raw corn in view of its limited storage facilities and the expense of increasing those facilities sufficiently to take care of its needs. Purchases of futures were made when the price of corn was advantageously low. Petitioner took delivery of corn on some contracts, but it usually sold most of its futures in early summer if it then appeared that there would be no shortage of corn and no great danger of increased prices. If the crop was poor or there was danger of a price increase it sold its futures gradually as it bought corn for grinding. Petitioner

would begin to acquire additional futures contracts at harvest time each year.

The corn futures contracts were not subject to depreciation and were not included in inventory. Petitioner's raw corn inventory account was affected only when petitioner took delivery under a futures contract. Profits or losses on futures were shown in a "Corn Miscellaneous" account. The net gain or loss for each year was debited or credited to cost of sales, and treated as a reduction or addition to cost of goods sold.

During late 1939 and early 1940 petitioner maintained a long position in corn futures contracts of from 7,000,000 to 8,000,000 bushels. In 1940 the Commodity Exchange Authority formally charged petitioner with speculating in grain on the ground that it had a long position in excess by more than 2,000,000 bushels of the amount it required for hedging. At a hearing petitioner took the position that its futures were not in excess of its needs and that the contracts it held were necessary to cover the products which it expected to market over a period of 15 to 18 months. In demonstrating its needs petitioner submitted evidence as to its unfilled orders, its sales commitments, its contracts with the Huron Milling Company and the Keever Starch Company, and the estimated number of bushels of corn that would be required to meet such commitments. Petitioner relied also upon weekly and daily reports which it had filed with the Authority giving information as to its position with respect to grain futures. Petitioner had included in those reports, among other matters, detailed information as to its transactions in grain, and its purchase and sales commitments for grain, or grain products, and it stated in such reports that its futures were classifiable in character as hedging, rather than as speculative transactions. Petitioner was upheld in its contentions in the proceeding before the

Commodity Exchange Authority, and the action was dismissed.

The parties have stipulated the net gain or loss from the purchase and sale of corn futures in each year from 1932 to 1942, inclusive, the monthly purchases of bushels of raw corn by petitioner from January 1938, to December 1942, the monthly purchases and sales of corn futures during the same period including the number of contracts and number of bushels, the monthly purchases of corn futures from October 1937 to December 1942 under which delivery was taken at maturity dates, the monthly sales of corn futures from January 1938 through December 1942, including the number of contracts and number of bushels, and the stock on hand and unfilled orders for cerelose and for feed at the beginning of each month during the year 1942.

The parties have stipulated for each of the years 1939 and 1942 the separate gain or loss to petitioner resulting from the sale of corn futures held for not more than six months and from the sale of corn futures held for more than six months, as computed both with and without the application of section 118 of the Internal Revenue Code.

During 1942 petitioner had gross sales of more than $131,000,000 and gross profits from sales of more than $35,000,000. Its net loss from the purchase and sale of corn futures was $109,969.38. At the beginning and end of that year its inventory (including raw corn and processed products valued at cost or market, whichever was lower) was approximately $7,650,000 and $5,900,000, respectively.

There was no significant change in petitioner's method of doing business between December 31, 1940, and December 31, 1942.

Petitioner's purchases of corn futures did not constitute speculative transactions for profit, but were consummated

in order to obtain business protection and to insure the profitable conduct of its business.

Issue 2

During all periods material to this proceeding the books and records of petitioner and its subsidiaries were kept on an accrual basis.

During 1939 Maizena, Brazil, S. A., a Brazilian corporation, hereinafter called Maizena, and Refinacoes De Milho, Brazil, S. A., a New Jersey corporation, hereinafter called Refinacoes, were petitioner's wholly-owned subsidiaries. In that year Refinacoes owed Maizena money for commissions. On the books of Maizena the commissions were credited to profit and loss, and debited to its accounts receivable account for Refinacoes. Maizena paid taxes to Brazil upon the commissions.

In December 1938 Maizena declared a dividend, payable January 13, 1939, and set up on its books an account payable to petitioner in the amount of 2,175,000 Brazilian milreis. In June 1939 petitioner debited an accounts receivable account known as blocked account, Maizena, Brazil, S. A., and it credited blocked income which was a deferred credit income account. Petitioner used a rate of exchange of 5.95 cents per milrei. The Internal Revenue Bulletin stated that the rates of exchange acceptable as the prevailing current or market rates were 5.86 per milrei as of December 30, 1938, and 6.058 cents per milrei as of December 30, 1939. There was also an unofficial rate of exchange in Brazil.

Petitioner was interested at that time in selling milreis for dollars to foreign exchange dealers in New York, if favorable rates were obtainable. There were restrictions in Brazil in 1939 with respect to transmitting funds out of that country. The record does not disclose the nature or extent of such restrictions.

Appendix B

In 1939 petitioner received a portion of the above dividend in the amount of $4,862.31, which was the dollar equivalent of 100,649.9 milreis. That payment was made by draft, payable in petitioner's favor, and drawn by the Bank of Brazil upon the Guaranty Trust Co. The record does not disclose the circumstances under which such drafts were procured. Petitioner received the balance of the dividend in 1940. Upon receiving payment petitioner debited its cash and blocked income accounts, and credited income and its blocked account, Maizena, Brazil, S. A.

During 1939 petitioner was a major stockholder in several Italian companies, including S. A. Anficromos Dott Aldo Volpino-Milan, hereinafter called Anticromos, S. A. Ligure Industriale Commerciale-Genoa, hereinafter called Ligure, S. A. Prodotti del Mais-Milan, hereinafter called Prodotti, and Fabbriche Riunite Amido Glucosia Destrina-Milan, hereinafter called Fabbriche. Petitioner had wholly-owned Italian subsidiaries, including Societe Finanziaria Agricola Italo-Americana-Milan, hereinafter called Finanziaria.

In May 1939 dividends in lire were declared by the above corporations and set up on their books as accounts payable to petitioner, as follows: Anticromos—142,920; Ligure—565,763; Prodotti—1,643,718; and Fabbriche—2,143,926 lire. In that year petitioner entered the above amounts on its books by debiting its accounts receivable maintained for the above corporations which were called blocked accounts; and by crediting its blocked income account, which was a deferred credit to income. Petitioner used a rate of 5.2625 cents per lire which was the published rate of exchange on the date of declaration of dividends.

The dividends declared by Anticromos and Ligure were paid in the same year to petitioner's subsidiary, Finanziaria. Finanziaria credited petitioner's account and ac-

crued interest which was also credited. An undisclosed portion of the dividends received by Finanziaria and an undisclosed portion of the dividends declared by Prodotti and Fabbriche were transferred on undisclosed dates to Italian banks for petitioner's credit. The record does not disclose when the Italian dividends which were declared in 1939 payable to petitioner were received by the latter.

Petitioner was anxious at a reasonable price to realize dollars for its lire, and it was able in New York to sell to foreign exchange dealers some of the lire in its bank accounts at unofficial rates. In November and December 1939 petitioner converted the sums of 210,000 and 200,000 lire into dollars at an average rate of approximately $.021 per lira. The latter lire would come out of dividends declared in 1936, if treated on a first in, first out basis. The record does not disclose the nature or extent of the exchange restrictions in Italy on transmitting funds out of that country.

Petitioner's consistent bookkeeping practice, in treating a foreign dividend payable to it and blocked by exchange restrictions, has been to record the dividend as a receivable at the prevailing rate of exchange with a credit to deferred income, and to treat the amount as income in the year of actual receipt in the United States. Petitioner has adhered to that procedure following an internal revenue agent's suggestions in connection with examinations of its returns for certain years prior to the period here involved.

Petitioner's 1939 tax return reported as income the portion of the Maizena dividend received in that year. It did not report the remainder of the Maizena dividend or the dividends declared in that year by the Italian corporations. That method of reporting was in accordance with petitioner's practice, in 1939 and subsequent years, of reporting items of foreign income, blocked by exchange

restrictions, at the time of actual receipt, and treating them as capital gain items with a cost basis of zero.

The dividends in controversy were not unqualifiedly subject to petitioner's demand in the year 1939. In 1939 there was no market for the unconverted Brazilian milreis and the Italian lire here in controversy, and no one could form an opinion as to their values in that year.

Issue 3

During 1942 petitioner paid out as "salaries" the gross sum of $37,620.44. The net amounts so paid were in fact embezzled by the paymaster and were not received by the employees designated on the checks as payees. The total sum of $37,620.44 was deducted in good faith as part of cost of sales. In addition, based upon the above "salaries," petitioner withheld and paid to the Treasury, as the employer's portion of Federal Old Age Benefit, the amount of $357.39, and as Federal Unemployment Insurance the amount of $676.55. The latter sums were deducted in good faith.

In 1948 petitioner discovered the embezzlements and made a claim for reimbursement from its surety under its policy of insurance which was in effect at all times. In 1949, under the terms of its policy, petitioner received from the surety reimbursement of the above sum of $37,620.44, without interest.

Respondent's notice of deficiency, mailed on December 14, 1948, did not disallow any of the above sums. At the hearing, respondent claimed an additional deficiency based upon the disallowance of the amount of $37,620.44 as a deduction for 1942.

Issue 4

Petitioner had no excess profits tax liability for 1941, and in so determining, respondent excluded from peti-

tioner's excess profits net income for that year the sum of $436,945.36 as abnormal income under section 721 of the Internal Revenue Code. Respondent's computation of petitioner's unused excess profits tax credit carry-over from 1941 to 1942 did not exclude from petitioner's excess profits net income for 1941 the said amount of $436,945.36.

OPINION

I.

Issue 1(a).

Although perhaps not conforming technically to the definition of a hedge,[1] it seems indisputable as our findings show that petitioner's practice of purchasing corn futures was an integral part of its manufacturing business. *Ben Grote*, 41 B.T.A. 247; see *Kenneth S. Battelle*, 47 B.T.A. 117, 127. It would hence be anomalous to view them as purely speculative transactions of a capital nature,[2] especially considering that this is "largely a factual question," *Kenneth S. Battelle*, *supra*, 125, and the burden here is on petitioner to show that it incorrectly treated the losses as ordinary on its original tax returns. Only by so doing can it succeed in maintaining its present position that losses in the base period were improperly

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1 "* * * to hedge, i.e., to insure themselves against loss by unfavorable changes in price at the time of actual delivery of what they have to sell or buy in their business; * * *." *United States v. New York Coffee & Sugar Exchange, Inc.*, 263 U. S. 611. See Patterson, "Hedging and Wagering on Produce Exchanges," (1931), 40 Yale L. J., 843, 846.

2 "* * * For example, if a manufacturer or processor of raw materials is short on inventory and make sales of his finished products for forward delivery, the appropriate hedging transaction in that instance would be the purchase of raw material futures at or about the time he makes the sale." *Stewart Silk Corp.*, 9 T. C. 174, 178.

employed to arrive at a smaller income than actually received.

Futures contracts need not be concurrent with spot transactions in order to be a hedge. G. C. M. 17322 (1936), XV-2, C. B., 151. In neither *Tennessee Egg Co.*, 47 B.T.A. 558, nor *Estate of Dorothy Makransky*, 5 T. C. 397, affirmed (C. A. 3), 154 Fed. (2d) 59, were there future commitments against which the futures purchased could operate as an offset. In the former, petitioner's failure to sustain its burden of proof is emphasized, and in the latter the venture in question was an isolated transaction and not a component of a regular practice of balancing transactions systematically conducted. Neither case is authority militating against our conclusion that petitioner's losses on its futures contracts were properly treated as ordinary losses. *Stewart Silk Corp.*, 9 T. C. 174, 179.

II.

Issue 1(b)

Petitioner's alternative contention that Internal Revenue Code, section 118, forbade deduction of these losses as wash sales must be rejected on authority of *Corn Products Refining Co.*, 16 T. C. 395, a prior decision involving this same petitioner from which we see no reason to depart.

III.

Issue 1(c)

That the futures contracts gave rise to a separate class of losses, however, we think admits of little doubt. Al-

though related to petitioner's cost of operations, they cannot be considered an inventory item, *Modesto Dry Yard, Inc.*, 14 T. C. 374, nor, since the grain itself was never acquired, a part of the costs of goods sold. See *Tennessee Egg Co., supra; Estate of Dorothy Makransky, supra; Modesto Dry Yard, Inc., supra.* Being losses on transactions comparable to hedges, they are strictly similar only to other hedge transactions. We conclude that, being greater than 125 per cent of previous items of the same character, the losses are subject to treatment under section 711(b)(1)(J)(ii). *Green Bay Lumber Co.*, 3 T. C. 824; *Welch Grape Juice Co.*, 9 T. C. 786; *Mine and Smelter Supply Co.*, 10 T. C. 1179.

For the first time on brief, respondent seeks to invoke the provisions of section 711 (b)(1)(K). Assuming that the ordinary burden of disclosure rested upon petitioner in that state of the record, but see *Green Bay Lumber Co., supra; Wentworth Manufacturing Co.*, 6 T. C. 1201, it has in our view been adequately met. There is no apparent causal connection between the losses on futures and the gross income or deductions of petitioner's operations. And the abnormal losses do not seem to have been a consequence of a change in the manner and scope of petitioner's operations. *R. C. Harvey Co.*, 5 T. C. 431; *Laredo Bridge Co.*, 7 T. C. 17.

If there are more obscure connections between the contested losses and any of the enumerated aspects of petitioner's activities as described in section 711(b)(1)(K), it was incumbent on respondent to give some adequate notice of his proposed position. A taxpayer cannot be expected to negative every possible element of some hypothetical defense. *Wentworth Manufacturing Co., supra.*

In this respect respondent's determination was erroneous.

Appendix B

IV.

Issue 2

On petitioner's claim that it understated its 1939 income by failing to report dividends received in Brazil and Italy, we conclude that the burden of proof which rested on petitioner has not been discharged. It is not sufficient for the dividends to have been received in foreign territory. They must have been convertible into American dollars before petitioner could be charged with them as income. *Foundation Co.*, 14 T. C. 1333. This was one of the issues in the case and proof of convertibility was requisite under the circumstances. *International Mortgage & Investment Corp.*, 36 B.T.A. 187. In *Weil* v. *Commissioner* (C. A. 2), 150 Fed. (2d) 950, the taxpayer had the burden of proving the absence of free convertibility, rather than as here, its presence, and failed to carry it. Petitioner's failure to sustain its burden in this respect is the basis for our conclusion contained in the findings that there was no market for the foreign exchange in dispute.

In fact, what evidence there is indicates that these payments were actually blocked by the respective exchange restrictions of the countries involved. The facts show that except for a small portion actually converted in some manner not disclosed, and not here in controversy, the entire amount was credited to deferred income. This was stated to be petitioner's method of dealing with blocked funds: "If the foreign dividend payable to us was blocked by exchange restrictions our practice was to book the dividend as a receivable at the prevailing rate of exchange, offset by a credit to the deferred income, taking it into income in the year it was received." When the dividends were "received," that is, when they were exchanged into dollars and transferred to the United States—all of which

occurred subsequent to the year in issue—and not until then were they recorded as income. On this issue the deficiency is sustained.

V.

Issue 3

We do not view the issue affirmatively raised by respondent as one directly involving the deductibility of an embezzlement loss. At the close of the taxable year in question, 1942, from all that was then known, petitioner correctly deducted the amounts in issue as compensation for services. The fact that six years later it was discovered that these items had never been paid to the employees but had been misappropriated and that a year after that petitioner was able to collect from its insurer would, as in *E. B. Elliott Co.*, 45 B.T.A. 82, be pertinent facts for consideration if the year 1942 could be dealt with in reliance upon them. But as we have frequently reiterated, the *Elliott* rule no longer applies. *Standard-Tilton Milling Co.*, 3 T. C. 1026; *Taylor Instrument Companies*, 14 T. C. 388.

Only by reviewing the year in controversy in the light of facts discovered many years later can petitioner's position be attacked. This as we have said we are no longer in a position to do. *Schwabacher Hardware Co.*, 45 B.T.A. 699, was decided after *E. B. Elliott Co., supra*, and on its authority, and before *Standard-Tilton Milling Co., supra*. For that reason it has no application to these proceedings. And in *Samuel M. Felton*, 5 T. C. 256, the burden was not upon respondent, as it is here, but upon petitioner. Under the *Security Flour Mills*[3] rule, respondent has not even closely approximated the discharge

[3] *Security Flour Mills* v. *Commissioner*, 321 U. S. 281.

of the burden which he is required to bear. On this issue, decision will be for petitioner.

Issue 4

The final question is controlled by *San Francisco Stevedoring Co.*, 8 T. C. 222, as petitioner concedes. It attacks the conclusion there reached and urges us to depart from it. This we are unwilling to do. On the authority of that case, the deficiency is sustained in this respect.

Decision will be entered under Rule 50.

CORN PRODUCTS REFINING CO., PETITIONER, v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

(U. S. Court of Appeals, Second Circuit, Nos. 158, 159, Aug. 25, 1954)

Before: Chase, *Chief Judge*, Hincks and Harlan, *Circuit Judges.*

Consolidated petitions to review decisions of the Tax Court redetermining a deficiency in the income taxes of the petitioner for 1940 and deficiencies in its excess profits taxes and declared value excess profits taxes for 1942. Affirmed.

Jay O. Kramer, Samuel A. McCain, Attorneys for Petitioner.

H. Brian Holland, Assistant Attorney General, Ellis N. Slack, Lee A. Jackson, Harry Marselli, Special Assistants to the Attorney General, for Respondent.

Appendix B

Chase, *Circuit Judge*:

The petitioner, a New Jersey corporation which has its principal office in the City of New York, is engaged in manufacturing and selling corn products, including sugars, starches, oils and feeds. The Commissioner determined a deficiency of $163,804.78 in its income tax for 1940; a deficiency of $1,520,519.39 in its excess profits tax for 1942; and a deficiency of $14,487.94 in its declared value excess profits tax for that year. The Tax Court upheld the Commissioner and petitions to review its decisions have been consolidated for hearing in this court. The opinion of the Tax Court and its findings of fact as to the issues for 1940 are reported at 16 T. C. 395 and familiarity with them will be assumed. Reference is also made to the unreported opinion and findings of fact of the Tax Court, as to the issues for 1942, in Tax Court Docket No. 22,074.

Four questions are presented as to the tax liability of the petitioner for the years 1940 and 1942. Involving both 1940 and 1942 are questions of the taxability of profits and losses in the purchase and sale of corn futures as ordinary income and loss or as capital gain and loss under Section 117(a) of the Internal Revenue Code, 26 U. S. C. A. § 117(a), and the applicability of Section 118 of the Code, 26 U. S. C. A. § 118, to those transactions. Involving only the tax year 1942, are two questions related to the petitioner's excess profits credit and carry-over.

In its business the petitioner uses large amounts of corn, often as much as 170,000 bushels per day. The maximum amount of raw corn which it could store during the relevant periods was roughly 2,300,000 bushels, only about three weeks supply, so it decided to deal in corn futures in order to insure a stable price for the raw product by thus eliminating price fluctuations caused by occasional supply shortages on the market. The method adopted was to purchase corn futures through a commodity ex-

change whenever the price of corn was satisfactorily low and hold them until it could be ascertained whether there would be a crop shortage. Then the futures would be in part liquidated if, and when, need for retaining them ceased because of the condition of the anticipated crop. The method was followed each season.

The petitioner had future sales commitments, but these were mainly of an unfixed character in that the purchaser was given the benefit of the lower of the order price or the delivery date market price. So, with long purchases of futures set against future sales at the order or market price, whichever was lower, the respondent protected itself against commodity price rises but not against declines.

In the years 1940 and 1942 the petitioner's purchases and sales of corn futures resulted respectively in a gain of $680,587.39 and a loss of $109,969.38 and in its tax returns for those years these were treated as items of ordinary income and loss, being entered in petitioner's books as an increase and decrease in cost of goods sold. However, from 1940 to 1946 the Commissioner successfully contended in a series of instances[1] that dealings in commodity futures contracts gave rise to capital, rather than ordinary, gains and losses and in reliance on those cases the petitioner sought to have them treated as capital in nature under Section 117(a) of the Code.

In addition to seeking capital treatment on these items the petitioner also contended that many of the past futures transactions came within the "wash sales" provision of Section 118 which would do away with loss deduction under Section 23(f) and transfer the basis of the "washed" security to the purchased security and, in this case, increase the basis of those futures sold in 1940 and 1942.

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[1] *George W. Covington*, 42 B. T. A. 601; aff'd 5 Cir., 120 F. 2d 768, cert. denied 315 U. S. 822; *Tennessee Egg Co.*, 47 B. T. A. 588; *Trenton Cotton Oil Co.* v. *Commissioner*, 6 Cir., 147 F. 2d 33; *Farmers & Ginners Cotton Oil Co.* v. *Commissioner*, 5 Cir., 120 F. 2d 772, reversing 41 B. T. A. 1083; *Makransky, Estate of Dorothy, Deceased, et al.*, 5 T. C. 397, aff'd 3 Cir., 154 F. 2d 59.

The Tax Court held that these commodity transactions gave rise to ordinary income and loss since the petitioner's system of purchasing corn futures "was an integral part of its manufacturing business." It is the position of the petitioner to the contrary that, within the meaning of Section 117(a), commodity futures contracts are "property held by the taxpayer" and do not come within the types of property excluded from the section, not being stock in trade, inventory, property held primarily for sale to customers, or the like, and therefore capital in nature.

In addition to those exclusions specifically provided for in Section 117 the petitioner contends that the courts have set up a "judge-made exception"; that is, that gain and loss from commodity futures transactions will not be given capital treatment when they have been utilized for the commercial purpose known as "hedging." And, even assuming that this "judge-made exception" is proper, it would not be applicable here because the petitioner, so it claims, was not hedging. We think the petitioner has misconstrued the effect both of the cases and of its own dealings.

Hedging is a method of dealing in commodity futures whereby a person or business protects itself against price fluctuations at the time of delivery of the product which it sells or buys. *United States* v. *New York Coffee & Sugar Exchange*, 263 U. S. 611. A typical example of hedging occurs when a manufacturer of grain products seeks to stabilize its costs against fixed forward sales prices. Having contracts for the delivery of its grain products to its customers at fixed prices, the manufacturer seeks to set the cost of its related inventory item, grain, by entering into futures contracts for the purchase of it. By so doing the manufacturer may later obtain the necessary grain at a price properly related to the already fixed selling price of his manufactured product and, so far as commodity

costs are concerned, the profit from manufacturing is insured.

In *United States* v. *New York Coffee & Sugar Exchange, supra,* the Supreme Court set forth three general classifications of dealings in commodity futures: speculation, legitimate capital transactions, and hedging. These classifications have since been adopted as convenient nominal guides by the courts to determine the proper tax consequences of futures transactions.[2] Where futures are dealt with for the purposes of speculation or what is called legitimate capital transactions, they obviously fall outside the possibly relevant exclusions of Section 117(a). In the hedge, however, the property is used in such a manner as to come within the exclusions, for it is a part of the inventory purchase system which is utilized solely for the purpose of stabilizing inventory cost. It is an integral part of the productive process in which the property is held not for investment but for the protection of profit with the intent of disposition when that purpose has been achieved. As such it cannot reasonably be separated from the inventory items and the cost (or profit) from such operations would necessarily be entered in the books of account of the business as part of cost of goods sold. The tax treatment of hedges, then, is not a "judge-made exception" to Section 117(a); it is simply a recognition by the courts that property used in hedging transactions properly comes within the exclusions of the section.

The futures transactions of this petitioner, it is true, did not constitute what is known as "true" hedging. The true hedge can occur only when forward sales prices are fixed and the relation between commodity purchase and later sales price is insured against both increase and decrease of commodity prices. As the forward sales prices here were based mainly on the lower of order or market prices, the petitioner was protected only against increases

[2] See cases cited in footnote 1.

in commodity prices and did not have the complete insurance of the true hedge. But this is a distinction presently of no significance. The property here was used for essentially the same purpose and in the same manner as in true hedging. Futures contracts were entered into to stabilize inventory costs and thus protect profit, and whether complete or only partial insurance was thereby obtained is simply a difference in degree, not in kind. Therefore, for the same reasons that the true hedge is not accorded capital treatment under Section 117(a), the kind of transactions with which we are now concerned are not to be regarded as capital ones either.

The petitioner's further contention that the wash sales provision of Section 118 is applicable to its futures transactions rests on *Trenton Cotton Oil Company* v. *Commissioner*, 6 Cir., 147 F. (2d) 33, rehearing denied 148 F. (2d) 208. With deference, however, we find ourselves unable to agree with that decision. Cf. *Harriss* v. *Commissioner*, 2 Cir., 143 F. (2d) 279; *Valley Waste Mills*, 5 Cir., 115 F. (2d) 466, cert. denied 312 U. S. 681.

Disallowance of loss deduction under Section 118 occurs only on the sale and purchase of "shares of stock or securities," and only if the stocks or securities purchased are "substantially identical" with those sold. The transactions here are distinguishable on both grounds, for reasons well stated in the opinion below. On the question of substantial identity the Tax Court said: "Furthermore, a new future commodity contract is not 'substantially identical' with any prior contract even though the quantity involved in each is identical. It would be purely accidental if the new contract was with the same party as the one who had agreed to sell the commodity in the earlier contract. The price would probably be different and the delivery date would certainly be different." And on the question of whether commodity futures contracts are securities: "it is apparent from the opinion (*Valley Waste*

Mills v. *Page*, 115 F. (2d) 466, cert. denied, 312 U. S. 681) that such a future is not a security in any generally recognized sense but simply a contract between two parties in which one agrees to supply at a designated time in the future a stated quantity and quality of goods, upon payment of a stated price and on which a part of the contract price, called a margin, has been paid by the buyer to his broker to bind him until the sale is consummated or the contract is sold * * *" We are in accord and take the above as the correct analysis and disposition of this point.

The third point raised by the petitioner is that the Tax Court erred in not holding that dividends declared by certain foreign corporations and payable to petitioner in 1939 were includible in its income for 1939. The effect of the inclusion of those amounts in 1939 income would be to increase petitioner's excess profits credit and its unused excess profits carry over to the year 1942, and thereby reduce the 1942 excess profits tax.

In 1938 a Brazilian corporation, wholly owned by petitioner, declared a dividend of 2,175,000 Brazilian milreis, payable in 1939. In 1939 four Italian corporations in which the petitioner was a major stockholder declared and made payable to petitioner dividends totalling 4,496,327 lire. These dividends were, however, payable only in blocked currency. Consistent with its practice of treating blocked foreign dividends as income only when actually received in the United States in dollars, the petitioner entered these dividends on its books of account as deferred income and did not report them as income in 1939 for tax purposes.

In order to prove that the foreign dividends should have been included in 1939 income, it was necessary to show that instead of being blocked the dividends were in fact freely convertible into dollars. The petitioner offered as such proof the fact that in 1939 it had converted 100,

649.9 milreis and 410,000 lire into dollars. There was no showing of the manner of conversion. The Tax Court held that this evidence was not sufficient to discharge the petitioner's burden of proof and accordingly held that the foreign dividends were not includible in 1939 income.

The petitioner insists that the Tax Court erred both in putting the burden of proof on the petitioner and in not holding its evidence of conversion of some milreis and lire into dollars to be sufficient proof of free convertibility. As to the burden of proof it is so well settled as not to need much comment that in proceedings before the Tax Court the petitioner must *affirmatively* establish its case. *Edward T. Weil, Inc.* v. *Commissioner*, 2 Cir., 150 F. (2d) 950, on which the petitioner relies for the proposition is not in conflict with the general rule but recognizes expressly that, "The burden was upon the taxpayer to establish that the assessment of gain could not be made upon the basis of current exchange."

Rule 32 of the Rules of Practice before the Tax Court, 26 U. S. C. A. § 1111, provides: "The burden of proof shall be upon the petitioner, except as otherwise provided by statute, and except that in respect of any new matter pleaded in his answer, it shall be upon the respondent." The issue of convertibility is not the subject of other legislation shifting the normal burden and here the issue was not new matter pleaded in the respondent's answer. Accordingly, the exceptions are inapplicable and the burden of proof was properly placed on the petitioner.

The evidence amply supports the Tax Court's conclusion that the petitioner failed to prove free convertibility. Only small portions of the dividends were converted into dollars, and the manner of conversion was not even shown. The entire remainder of the dividends was treated as deferred income. Such a showing, far from being adequate proof of free convertibility, tended to suggest the lack of it.

Appendix B

The final point raised by the petitioner is concerned with a determination with respect to abnormal income under Section 721 of the Code. But Section 732(c), which provides that any determinations made solely by reason of Section 721 of the Code are final and "shall not be reviewed or redetermined by any court * * *" deprives us of jurisdiction to review this determination. *George Kemp Real Estate Co.* v. *Commissioner*, 2 Cir., 182 F. 847, cert. denied 340 U. S. 852; *James F. Waters, Inc.* v. *Commissioner*, 9 Cir., 160 F. (2d) 596, cert. denied 332 U. S. 767.

Decision affirmed except as to the final point and as to that the petition is dismissed for lack of jurisdiction.

APPENDIX C

ESTATE OF DOROTHY MAKRANSKY, DECEASED, *et al.*, PETITIONERS, v. COMMISSIONER OF INTERNAL REVENUE

(U. S. Circuit Court of Appeals, Third Circuit, Nos. 9076-9080, February 25, 1946)

On petitions for review of Decisions of the Tax Court of the United States.

Before Maris, Goodrich and O'Connell, Circuit Judges.

OPINION OF THE COURT

Per Curiam:

In these cases the taxpayers ask this court to review the finding of the Tax Court that a loss which they incurred in the sale of contracts for the future delivery of wool was a loss upon the sale of capital assets and not an ordinary and necessary expense of their business deductible under Section 23(a) of the Internal Revenue Code or a loss deductible under Section 23(e). We think that this is a finding which this court is not at liberty to review. *Dobson* v. *Commissioner*, 320 U. S. 489 (1943); *Kelley Co.* v. *Commissioner*, — U. S. — (1946).

The decision of the Tax Court is affirmed.

ESTATE OF DOROTHY MAKRANSKY, DECEASED, *et al.*, PETITIONERS, v. COMMISSIONER OF INTERNAL REVENUE

Docket Nos. 3353, 3354, 3355, 3356, 3357.

Promulgated July 12, 1945.

Petitioners were the members of a partnership engaged in the business of manufacturing men's suits from piece material. At the outbreak of the present war all lines of piece goods were withdrawn from the market. At that

time the partnership had on hand only a six-month supply of piece goods. During September 1939 it purchased on margin through a broker certain futures contracts calling for delivery of wool tops in March 1940. At the time these contracts were purchased the partnership intended to take delivery of the wool tops and have them converted into piece material. Towards the close of 1939 piece goods were again offered on the market and the partnership learned that the wool tops to be delivered in March were of an inferior grade and could not be used in its business. During February 1940 it sold the futures contracts at a substantial loss. *Held*, the loss thus sustained by the partnership was a "short-term capital loss" as that term is defined in section 117(a) of the Internal Revenue Code and was not a business expense deductible from gross income under section 23(a)(1)(A); *held, further*, the partners are not entitled under sections 23(s), 122, and 189 to deduct from their gross incomes for the taxable year 1941 any "net operating loss carry-over" on account of the loss sustained by the partnership on its wool tops futures contracts.

Samuel H. Levy, Esq., for the petitioners. W. J. McFarland, Esq., for the respondent.

These proceedings, duly consolidated, involve deficiencies in income tax for the calendar year 1941 determined by the respondent against petitioners in the amounts of $3,961.82, $4,403.37, $4,166.11, $3,720.08, and $4,169, respectively.

The deficiencies result from the respondent's determination that each petitioner should be taxed with "Income from partnership" of $17,564.54 ($17,564.53 in Docket Nos. 3354 and 3356) not reported on their individual returns. This adjustment was identically explained in each deficiency notice as follows:

Your distributive share of income from the S. Mak-

ransky & Sons partnership has been adjusted to reflect the disallowance of an alleged 1940 operating loss carried over and claimed as a deduction by the partnership in its return for 1941.

By appropriate assignments of error each petitioner contests this adjustment.

The respondent also allowed each petitioner, except Edward Makransky in Docket No. 3354, additional deductions for contributions, but these adjustments are not in controversy.

Findings of Fact.

Many of the facts have been stipulated. The stipulation and the exhibits thereto are incorporated herein by reference.

Petitioners in Docket No. 3353 are the executors of the will of Dorothy Makransky, who died on December 31, 1943. The original petitioner in Docket No. 3353 was Dorothy Makransky, an individual, residing in Philadelphia, Pennsylvania. She filed her income tax return for the calendar year 1941 with the Collector for the First District of Pennsylvania.

Petitioners in the remaining dockets are individuals and residents of Philadelphia, Pennsylvania. They too filed their income tax returns for the calendar year 1941 with the collector for the first district of Pennsylvania. At all times material herein Dorothy Makransky and the petitioners in the remaining dockets composed the partnership of S. Makransky & Sons, hereinafter sometimes referred to as the partnership. The partnership filed returns for the calendar years 1940 and 1941 with the collector for the first district of Pennsylvania.

The partnership is the successor to the clothing business of S. Makransky & Sons, Inc., a Pennsylvania corpora-

tion. Since prior to 1918 the partnership and its predecessor concerns have been engaged in the City of Philadelphia, Pennsylvania, in the manufacture and sale to retailers of men's ready-to-wear suits. The finished stock of the partnership is sold by retailers under the partnership's trade name of "Devonshire Clothes" or under the name of the retailer.

The partnership obtains piece goods from weavers of woolen or worsted cloth, which are sponged by an independent contractor in order to pre-shrink the cloth and are then manufactured by the partnership into the finished clothing. Orders for the purchase of piece goods by the partnership for the spring and summer line are placed with the weavers principally during the preceding July and August, and deliveries are made to the partnership by the weavers commencing in December and extending through the subsequent months of January, February, and March. Orders for the purchase of piece goods by the partnership for the fall and winter line are placed with the weavers principally during January and February and deliveries are made by the weavers to the partnership commencing in June and extending through the next succeeding three months of July, August, and September.

The partnership employs numerous salesmen to sell its finished product to retailers throughout the United States. In this connection, sample suits and swatches of its prospective spring and summer line are made up by the partnership and furnished its salesmen during September and October. Its salesmen contact prospective purchasers during the fall season for the purpose of obtaining orders for the sale of the finished stocks of the partnership for the following spring and summer. Actual manufacture by the partnership in accordance with the sales orders obtained by its salesmen is conducted by the partnership over the period from about November through the sub-

sequent month of April and sometimes May. As to the fall and winter line, sample suits and swatches are furnished to the salesmen during the preceding March and April. Sales orders are taken by the salesmen during April and May from prospective purchasers and the actual manufacture of its finished stock with which to fill the sales orders is conducted by the partnership during the period of June through October and sometimes November.

All orders for its finished product were accepted by the partnership subject to the following conditions fully set forth in the orders:

"We are not responsible for the late or nondelivery of all or any part of this order due to fire, strikes, inability to procure piece goods or due to government orders or any other reason; nor does the delivery of any part of this order obligate us to deliver any other part hereof. We may discontinue shipment of any or all goods due you and cancel this and any other orders for you in case of your failure to make payments as agreed, or of any change in your credit standing. These prices are fixed—excepting if the seller's costs are increased by the imposition of government and/or state taxes, or by laws or regulations governing the working hours or compensation of labor, or by other increases in the rates of wages, in which case the buyer agrees to pay these increases. All orders subject to approval of our Philadelphia office."

During the year 1936 the partnership experimented in the manufacture of piece goods for its inventory requirements through contractors rather than purchasing finished piece goods from various weavers. The books of the partnership reflect payments of $12,523.26 and $15,196.27 to two different concerns, respectively, for spools of yarn delivered to the partnership over the period August to December 1936.

Appendix C

During the period November 1936 to February 1938 the partnership paid a weaver $5,840.62 for weaving the above mentioned spools of yarn into gabardine cloth, and paid a finisher and dyer $3,788.78 for finishing and dyeing the woven gabardine cloth. Approximately 15,000 yards of gabardine cloth were produced in this operation, and this yardage, after being sponged, was used by the partnership in the manufacture of its 1937 and 1938 spring and summer lines of finished stock.

In 1938 and 1939 the partnership engaged in the manufacture of additional piece goods for its inventory requirements through contractors. The transaction was carried out through Robert Rubenoff & Sons of New York City who were and are engaged in the business of converting wool tops purchased by clothing manufacturers and retail chain stores into finished cloth on a commission basis paid by the processors. Wool top is a blend of raw wool obtained from the various wool growing districts of the world. The blending of the raw wool into wool top is performed by a top maker.

On November 16, 1938, the partnership purchased through Robert Rubenoff & Sons 5,181 pounds of wool tops from Nichols & Co., Boston, Massachusetts, for immediate delivery to Cherry Brook Worsted Co., Woonsocket, Rhode Island. The wool tops were received by Cherry Brook Worsted Co. on November 19, 1938, and on November 23, 1938, the partnership ordered the worsted company to spin the wool tops into wool yarn. Between February 9 and February 14, 1939, the Cherry Brook Worsted Co. spun a total of 4,725 pounds of yarn, as ordered, and billed the partnership for the spinning, and, in accordance with instructions, shipped the yarn to Sterling Mills, Inc., Worcester, Massachusetts, for weaving into cloth.

The 4,725 pounds of yarn were received by Sterling Mills, Inc., between February 13 and February 16, 1939.

Appendix C

During the period February 23 to September 21, 1939, Sterling Mills, Inc., wove the total poundage of yarn into 3,888⅞ yards of finished woolen cloth, which was delivered to the partnership within this period. The partnership at all times retained title to the yarn and woven cloth. The cost per yard of the wool cloth produced and delivered was $2.20.

On September 22, 1939, the partnership purchased through E. A. Pierce & Co., at Philadelphia, Pennsylvania, 100 open contracts for the delivery of 500,000 pounds of wool tops under March 1940 wool tops futures contracts. Each of the contracts called for the delivery of 5,000 pounds of wool tops under its terms and in accordance with its provisions. The total cost of the 100 contracts was $589,955 (455,000 pounds at $1.18 per pound or $536,900 plus 45,000 pounds at $1.179 per pound or $53,055). At all times herein material the contracts were held in the name of E. A. Pierce & Co. The purchase of the contracts was made through the Wool Associates of the New York Cotton Exchange, Inc., by E. A. Pierce & Co. on the New York Wool Top Exchange. The partnership's commitment was margined at the rate of $250 per contract or $25,000 for the 100 contracts. E. A. Pierce & Co., in a letter to the partnership under date of September 22, 1939, confirmed the purchase of the contracts for the account of the partnership, as follows:

"We hereby confirm our purchase today for your account, 91 contracts of March Wool at 118.0 and 9 contracts at 117.9, (covering invoices for which will be mailed to you from our New York office), together with our understanding that you will margin these commitments at the rate of $250.00 per contract. We are not permitted, under the Rules of the New York Cotton Exchange—on which these contracts were purchased—to grant a credit extension; otherwise we would have been glad to have done so."

On the confirmation slips sent to the partnership by E. A. Pierce & Co. there was printed in small type the following:

"It is understood that the within and all other transactions made for your account by us contemplate actual receipt and delivery of the property and payment therefor and that all property sold for your account is sold upon the representation that you have same in your possession actually or potentially. These transactions are made subject to the rules, regulations and customs of the Board or Exchange on which they are made and subject to any and all Federal and/or State statutes to the extent that same may be applicable thereto. The right is reserved by us to close transactions without further notice when, in our judgment margins on deposit with us are below our requirements."

The 500,000 pounds of wool tops would produce approximately 375,000 yards of finished piece goods. Based on the processing costs incurred in the 1938 transaction, wool tops purchased at $1.18 per pound could be manufactured into piece goods at a cost of approximately $2.61 per yard.

On September 26, 1939, the partnership drew a check to the order of E. A. Pierce & Co. in the amount of $25,000 and the partnership's account with E. A. Pierce & Co. was credited with this amount. Additional deposit of margin was subsequently required which totaled $78,500 up to and including November 10, 1939.

The credit balance of the partnership appearing on the books of E. A. Pierce & Co. as of November 30, 1939, was in the amount of $103,500. On December 9, 1939, the margin was reduced by $28,500, resulting in a credit balance as of the close of the year of $75,000. During January 1940 the margin was increased to $102,000.

The wool tops futures contracts above described were

sold by E. A. Pierce & Co. on the New York Wool Top Exchange at the order of the partnership, commencing February 3, 1940, and terminating on February 16, 1940. The total sales price of these 100 contracts was $497,205. Commissions paid for selling were $3,000, and at the conclusion of the sales the account of S. Makransky & Sons on the ledger of E. A. Pierce & Co. was debited with $95,750.

The above $95,750 debited to the partnership's commodity account on the ledger of E. A. Pierce & Co. represents the total cost of the 100 contracts of $589,955, plus the commission of $3,000, less the total sales price of $497,205. The commodity account was never debited with the total cost of the 100 contracts, nor with the commission as such. Neither was it credited with the total sales price. It was simply debited with the net difference of these items as indicated above. After the account was debited with the above amount of $95,750 there remained a credit balance in favor of the partnership of $6,250 which represented the difference between the above-mentioned margin of $102,000 and the debit of $95,750. On or about February 17, 1940, E. A. Pierce & Co. sent the partnership a check for $6,250, and the partnership's commodity account on the ledger of E. A. Pierce & Co. was debited with a like amount, which entry closed out this account on the books of E. A. Pierce & Co.

The books of the partnership reflected the transactions in a manner similar to that used on the books of E. A. Pierce & Co.

The partnership did not record separately on its books the cost of the 100 contracts, the commissions charged by E. A. Pierce & Co., or the total sales price of the 100 contracts. On December 31, 1940, it merely charged the net result of these three items, namely, the above mentioned amount of $95,750, to "Woolens Purchases" and credited E. A. Pierce & Co. with a like amount, with the

explanation: "Cost of hedgings to protect purchases of woolens."

Attached to the stipulation as exhibits are balance sheets of the partnership as of December 31, 1939, and December 31, 1940, and operating statements of the partnership for the calendar years 1939 and 1940. On the balance sheet as of December 31, 1939, appeared an asset called "Deposit Commodity Futures Contract" in the amount of $75,000, which was explained in a footnote to the balance sheet as follows:

"This deposit has been made against the purchase of commodity futures at prices which were above the market quotations on December 31, 1939."

Section 75 of chapter III of the bylaws and rules of the Wool Associates of the New York Cotton Exchange, Inc., in effect during the years 1939 and 1940, provided in part as follows:

"All contracts for the future delivery of wool tops shall be in the following form:

"WOOL ASSOCIATES OF THE NEW YORK
COTTON EXCHANGE, INC.
WOOL TOP CONTRACT

New York, N. Y. .....19....

Sold Deliver to

"A. B. have this day Bought and agreed to Receive from C. D. 5,000 pounds of wool tops at the price of ..... dollars and ..... cents per pound for American find Top, Wool Top Exchange Standard, the seller having the option of delivering wool tops of other types or of inferior or superior quality at discounts and premiums, in accordance with the provisions of the By-Laws, Rules and Regulations of the Wool Associates of the New York Cotton Exchange, Inc. * * *

"Either party may call for a margin, as the variations of the market or like deliveries may warrant, which margin shall be kept good.

"This contract is made in view of, and in all respects subject to the By-Laws, Rules and Regulations of the Wool Associates of the New York Cotton Exchange, Inc.

* * * * *

"Verbal contracts (which shall always be presumed to have been made in the approved form) shall have the same standing, force, and effect as written ones, if notice in writing of such contracts shall have been given by one of the parties thereto to the other during the day on which such contract is made."

It was stipulated at the hearing that by the term "Wool Top Exchange Standard" referred to in the above mentioned uniform wool tops contract "is meant an average American fine wool top conforming to grade 64s official United States standards for wool tops, made out of merino wools, oil combed, and containing a normal percentage of 3 percent of oil including natural fat, produced from wool grown in and shorn from living animals in the United States, cleaned, scoured, carded, and combed in accordance with the methods and usages prevailing in the industry, and of average length and color."

During the years 1939 and 1940, wool tops deliverable to the purchaser under the terms of the uniform wool tops contract were restricted to wools shorn from living animals in Australia, South Africa, Argentina, Uruguay, and the United States.

Under the terms of the uniform wool tops contract wool tops blended from wools grown in woolgrowing districts of the United States were tenderable, but no other blends were acceptable. In addition, wool tops containing not more than 20 percent of pulled wools from the same country of origin and tops containing not more

than five percent of scoured wools resulting from a previous mill scouring were tenderable under the rules of the exchange.

The following wool tops were not tenderable or deliverable: (1) Tops having a mineral oil content, (2) tops combed in oil on French combs, (3) tops containing more than 1½ percent of any waste or reworked wools originating from other sources than the lot in process, (4) tops containing more than four percent oil including natural fat, or (5) tops composed of carbonized or contaminated wools.

Attached to the stipulation as an exhibit is a compilation of instructions to wool top inspectors, as amended by the board of governors of the New York Wool Top Exchange on recommendation of the Wool Top Committee, to become effective on all contracts on and after February 1, 1937.

The partnership borrowed money on short term unsecured loans to meet its pay roll and pay for the cost of its material. During the years 1938 and 1939, the partnership had an aggregate line of credit with three banks in the amount of $900,000.

The senior member of the partnership was Harry Makransky. He was responsible for buying the piece goods for the firm and for laying out its manufacturing policies. He had been in the business of manufacturing men's clothing for about 43 years. The comptroller and executive manager of the partnership is Milton Melnick. He was in charge of sales, the firm's accounting and records, the execution of its business policies, and the management of its office. He had been with the firm for over 23 years.

In the manufacture of its clothing the partnership used principally a 14 to 14½ ounce worsted cloth.

During the years 1939 and 1940 the wholesale prices for the suits manufactured by the partnership ranged

from $18 or $18.50 to $22.50. They were sold by retailers at prices between $35 to $40.

Over a period of years the partnership had established a regular clientele, including chain stores and other large concerns, which bought merchandise from it regularly each season. The partnership was an established source of supply for the large buyers, who relied on the firm to produce the goods which they required.

The war in Europe began on September 1, 1939. Following the outbreak of the war, the mills which manufactured piece goods and from which the partnership purchased the goods for their manufacturing needs withdrew all lines. No goods could be purchased.

Harry Makransky had been with the present firm, or one of its predecessors, since prior to the first World War. The business at that time also manufactured from finished piece goods and during that war he had had experience with the difficulties of obtaining the goods for manufacturing. The goods became very scarce, prices rose over 300 percent, and a poorer quality of merchandise was made.

Following the outbreak of the present war, the firm expected that its customers would continue to call upon it for their requirements and that these requirements might even increase. It was estimated that 500,000 yards of cloth a year would be required for the firm's manufacturing. In September 1939 the partnership had on hand and on order sufficient piece goods to provide the material needed to cover the firm's 1939 fall season and the 1940 spring season. With the withdrawal of all lines of piece goods in September 1939, the partnership found itself in a position where it could not make any purchases of additional cloth necessary for the continuance of the business.

Harry Makransky raised the problem with the other members of the firm and Melnick. He told them of the fact that the mills had withdrawn all lines and were not

showing any goods for sale, and discussed the bad situation in which this left the firm with respect to the future continuance of its manufacturing operations. He recalled the difficulties he had experienced during the first World War both in obtaining goods and in the prices which had to be paid. The current situation was even worse, since during the first World War goods could be purchased but now none at all were available. He wanted to do something to solve the situation and to remove the uncertainties. Various discussions were held among the members of the firm to determine what could best be done. The members concluded that the best thing to do was to buy wool tops and manufacture it into cloth. The above-mentioned purchase of the 100 contracts followed.

The plan was to take delivery of the tops in the spring of 1940. The manufacture of the partnership's 1940 Fall line would normally begin during the preceding June. Based on the partnership's prior experience, delivery of the finished piece goods could be anticipated within 60 to 90 days after delivery of the wool tops.

The partnership consulted a number of persons experienced in the business to assure themselves that facilities would be available for the spinning, weaving, and other processing of the tops into finished yarn. The partnership was assured that there would be no difficulty. It is not unusual for a manufacturer of men's clothing also to manufacture its own finished piece goods from wool tops through agents or contractors.

In their prior experience with the manufacture of their own piece goods, the partnership gave samples of cloth to the mills that make the cloth and instructed them to duplicate patterns. The samples are made up before the cloth is manufactured, being obtained from repeat numbers, mills, jobbers, and other sources. The same procedure was contemplated in the proposed new program. It was contemplated that the samples would also be fur-

nished to the salesmen for use in March and April of 1940 when they normally would sell the fall 1940 line. It would not be necessary for the salesmen to wait for the finished goods.

On September 21, 1939, Melnick telephoned the Philadelphia office of E. A. Pierce & Co., wool brokers, to inquire as to the purchase of wool tops. He was connected with Hibbard W. Roberts, an account executive. Roberts went to the offices of the partnership and discussed the matter with Harry Makransky and Melnick.

Melnick and Makransky explained their problem to Roberts and advised him of the partnership's decision to purchase wool tops to make their own worsteds to be manufactured into men's suits. They told him that their normal requirements were about 500,000 yards of cloth; that they wanted to buy 500,000 pounds of wool, which they estimated would produce about 375,000 yards of cloth, which they felt was a fair amount; and that they wanted the wool for delivery sometime in the spring, probably March. Roberts advised Melnick and Makransky of the procedure for purchasing the tops and the commissions involved; and that 500,000 pounds would require 100 contracts of 5,000 pounds each. In response to their inquiry, Roberts also informed Melnick and Makransky that the wool tops for March delivery were selling around $1.18 a pound.

Roberts was told that the partnership used a 14 to 14½ ounce worsted cloth, and that it wanted wool to make into such goods. They discussed the type of wool that would be received, and Roberts assured them that there was never any difficulty along these lines. No question was raised at this conference as to the possibility that South African Cape wool would be delivered on the contracts. Prior to that time Roberts had not experienced any difficulty in receiving deliveries of wool for such type of buyers.

If a holder of a wool contract received a type of wool which he could not use, he could retender it. The brokers would then get the type of wool he wanted and he would pay the difference in the premium. The broker sells the tops and rebuys what the contract holder can use. Melnick and Makransky were not acquainted with the details of this procedure, but they were assured and understood that there was no problem in getting a suitable wool.

Following the conference, Roberts discussed the order with his firm's research department in New York in view of the size of the order. They inquired about the type of wool the firm was using and the amount of cloth it was using, and did not seem to think that 500,000 pounds was abnormal. Roberts was authorized to accept the order, if the Philadelphia office was satisfied that S. Makransky & Sons was the type of firm with whom they usually dealt. Roberts thereafter advised Melnick that the order was acceptable to his firm. He was instructed to make the purchase, and the order was executed the next day.

Sometime after the contracts were purchased, widespread rumors developed that increased imports of Cape wool from South Africa were in prospect and that such wools would be tendered for delivery on the March 1940 contracts. Cape wool is a fast shrinking wool, used extensively in felts and velours. It is also used for women's wear, including hosiery, because of its fineness and softness. Used in the manufacture of a cloth for men's suits, the Cape wool would give the cloth a softer handle. It is not the type of cloth which large manufacturers of men's suits are acquainted with and find desirable. It was unsatisfactory for the type of clothing manufactured by the partnership.

Roberts had also learned of the rumors of increased imports of Cape wool in response to inquiries of his office as to why the future market on the exchange was selling

down. He called Melnick because this was something that he never had any experience with and which would be vital to the Makransky firm. He did not know whether they would be able to use wool from South Africa, and he wanted to put the firm on its guard. He had told Makransky that they would receive the type of wool that they wanted, but after the Cape situation arose he thought they might have difficulty in getting the type of wool Makransky wanted.

In addition to hearing the rumors that deliveries of Cape wool were in prospect, the partnership had also learned from cloth manufacturers that the South African wool was not suitable for the manufacture of the type of cloth which they used in the manufacture of their suits. This was a matter of common knowledge with the trade.

After receiving the call from Roberts, Melnick contacted Harry Makransky, who went to see Roberts. Roberts showed him the flash they had received stating that Cape wools might be received against the contracts, but told him that beyond this they were not informed on the matter. He informed Makransky that under this situation they might have difficulty in getting the type of wool they wanted.

Roberts arranged for Makransky to discuss the situation in New York with one Shlenker. Shlenker was in charge of commodities for E. A. Pierce & Co. In New York Makransky met with Shlenker and E. A. Beveridge, who was in charge of commodities' research for E. A. Pierce & Co. Shlenker and Beveridge confirmed to Makransky the rumors that there were prospects of Cape wools being delivered on the March contracts and that the contract permitted the seller to deliver such wools. Makransky stated that he could not use this type of wool in his business. Shlenker and Beveridge then took Makransky to the office of George H. Baston, in charge of the New York office of the Commodity Exchange Administra-

tion. Baston confirmed that the deliverer had the right to deliver tops from Cape wool if he so elected.

Following Makransky's visit to New York, he and the members of his firm and Melnick had a number of further discussions on the situation. Makransky made a further investigation to ascertain whether Cape wools could be used in their manufacturing. He visited a number of the firm's sources of supply, and was told they would not use Cape wools. There had been prior experimentations, and even a small amount would result in a shrinkage.

About the end of the year 1939, contrary to the situation feared in September, piece goods became more readily available, and the firm found that it could place purchases for cloth. During the month of January the market became better. The partnership decided that, since the finished piece goods now could be obtained and Capes were not suitable for their type of worsteds, they would dispose of the March contracts. They concluded that in view of the situation which had developed this was the sound business thing to do.

The partnership purchased the 100 contracts for the future delivery of wool tops as a means of acquiring the wool tops and with the intention and purpose of taking delivery of the wool tops for manufacture into piece goods which they would use in their business of manufacturing men's suits.

The partnership in its return of income for the calendar year 1940 reported an ordinary net loss of $87,808.68, which in schedule J it apportioned among its members as follows:

Dorothy Makransky	$17,561.73
Edward Makransky	17,561.74
Louis Makransky	17,561.74
Harry Makransky	17,561.74
Sadye Makransky	17,561.73

The loss of $87,808.68 was due principally to the fact that the partnership in arriving at its cost of goods sold included the above mentioned loss of $95,750 on sale of the 100 contracts as a part of its "Merchandise bought for sale" reported on its return in the amount of $1,318,319.10.

The partnership in its return of income for the calendar year 1941 reported an ordinary net income of $5,633.28, which in schedule J it apportioned among its members as follows:

Dorothy Makransky	$1,126.65
Edward Makransky	1,126.66
Louis Makransky	1,126.66
Harry Makransky	1,126.66
Sadye Makransky	1,126.65

In arriving at the above net income of $5,633.28 the partnership claimed as a deduction from gross income, among other items, an amount of $87,808.68 labeled "Net Loss Carry-over from 1940," which the respondent disallowed in determining the deficiencies herein.

The loss incurred in connection with the purchase and disposition of 1940 March wool tops futures contracts did not constitute an ordinary and necessary expense of the business of the partnership. The loss incurred in connection with the purchase and disposition of the 1940 March wool tops futures contracts did not constitute additional cost of the inventory of the partnership, nor was the loss incurred upon the sale of property which would properly have been included in the inventory of the partnership if on hand at the close of the taxable year.

The purchase of 100 March 1940 wool tops futures contracts by the partnership did not constitute a hedge by the partnership.

The loss of $95,750 sustained by the partnership during

the taxable year 1940 on the sale of the 100 wool tops futures contracts represented a loss upon the sale of a capital asset held for not more than six months.

OPINION

BLACK, *Judge*: Petitioners primarily contend that, under sections 23 (s), 122, and 189 of the Internal Revenue Code, they are entitled to carry over the 1940 loss of the partnership of $87,808.68 as a "net operating loss carry-over" in computing their individual tax liabilities for the calendar year 1941. Subsection (s) and sections 122 and 189 were all inserted in the code by section 211 of the Revenue Act of 1939. Section 122 was later amended by section 153 of the Revenue Act of 1942. As thus explained, the material provisions of these sections are set forth in the margin.[1]

The respondent contends that the loss of $95,750 on the sale of the 100 futures contracts sustained by the partner-

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[1] SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(s) Net Operating Loss Deduction.—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

SEC. 122. NET OPERATING LOSS DEDUCTION.

(a) Definition of Net Operating Loss.—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions and limitations provided in subsection (d).

(b) Amount of Carry-Back and Carry-Over.—

(1) Net operating loss carry-back.—If for any taxable year beginning after December 31, 1941, * * *

(2) Net operating loss carry-over.—If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over

ship in 1940 was a "short-term capital loss" as that term is defined in code section 117. If that be true, and since the partnership had no "short-term capital gains" during the calendar year 1940, there would be no net operating loss under 122 (a), no net operating loss carry-over under 122 (b), and no net operating loss deductions under 122 (c), for the reason that under the exceptions and limitations provided in 122 (d) "the amount deductible on account of short-term capital losses shall not exceed the amount includible on account of the short-term capital gains" and, therefore, instead of the deductions exceeding the gross income of the partnership for 1940 under 122 (a)

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in the case of the second succeeding taxable year shall be • • •

(c) Amount of Net Operating Loss Deduction.—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation • • •

(d) Exceptions and Limitations.—The exceptions and limitations referred to in subsections (a), (b), and (c) shall be as follows: • • •

(4) Long-term capital gains and long-term capital losses shall be taken into account without regard to the provisions of section 117 (b). As so computed the amount deductible on account of long-term capital losses shall not exceed the amount includible on account of the long-term capital gains, and the amount deductible on account of short-term capital losses shall not exceed the amount includible on account of the short-term capital gains: • • •

SEC. 189. NET OPERATING LOSSES.

The benefit of the deduction for net operating losses allowed by section 23 (s) shall not be allowed to a partnership but shall be allowed to the members of the partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

by $87,808.68, the gross income would exceed the deductions by $7,941.32. Petitioners, however, contend that the loss of $95,750 was not a short term capital loss, but was an ordinary business loss, or, in the alternative, an ordinary and necessary business expense deductible under code section 23 (a), as amended by section 121 of the Revenue Act of 1942, or as additional cost of goods actually taken into inventory during the year 1940. The material provisions of code sections 117 and 23 (a), as amended, are also in the margin.[2]

Was the loss of $95,750 on the sale of the 100 futures contracts a short term capital loss? The answer depends upon whether such contracts were or were not "capital assets" as that term is defined in code section 117. Under this definition the term "means property held by the

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[2] SEC. 117. CAPITAL GAINS AND LOSSES.

(a) Definitions.—As used in this chapter—

(1) Capital Assets.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l);

* * * * *

(3) Short-term capital loss.—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such loss is taken into account in computing net income.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or business expenses.—

(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *

taxpayer" with certain specified exceptions. These exceptions are (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or (2) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or (3) property used in the trade or business of a character which is subject to the statutory allowance for depreciation.

Petitioners contend that the contracts fall within the first exception as representing property of a kind which would properly be included in the inventory of the partnership if on hand at the close of the year. They argue that if, as originally intended, the partnership had taken delivery of the wool tops, and the wool tops had been on hand at the close of the year, there would be no question as to the inclusion in the inventory of the wool tops. Because of changed conditions, namely, the influx of Cape wools, and the availability again of piece goods, the partnership decided not to take delivery of the wool tops but to dispose of the futures contracts instead. Petitioners further argue that it is difficult to see a legal or practical justification for drawing a distinction between the tax treatment to be given losses realized on the disposition of materials physically taken into inventory and losses realized where futures contracts are disposed of before actual receipt of the commodities specified in the contracts due to a change in conditions over which the partnership had no control.

In *Anna M. Harkness*, 1 B. T. A. 127, 130, this statement appears:

It seems to us to be fundamentally unsound to determine income tax liability by what might have taken place rather than by what actually occurred. Even though the practical effect may be the same in either

case, the resulting tax liability may be quite different. *United States* v. *Isham*, 17 Wall. 496.

In the instant proceedings what actually occurred was a purchase and sale of futures contracts. It is well settled that such contracts are not to be included in the inventory. See sec. 19.22 (c)-1, Regulations 103; A. R. R. 100, C. B. No. 3, p. 66; A. R. M. 135, C. B. No. 5, p. 67; *Commissioner* v. *Covington*, 120 Fed. (2d) 768, 771; certiorari denied, 315 U. S. 822; *Tennessee Egg Co.*, 47 B. T. A. 558. In fact the partnership did not include the contracts in its inventory at the close of the year 1939 and it would have been improper to have done so. The only account it had on its books at that time relative to the contracts in question was the account with E. A. Pierce & Co. showing a debit balance of $75,000 for the margins that were up at that time. Neither were the futures contracts stock in trade nor property held primarily for sale to customers in the ordinary course of the partnership's trade or business. *Commissioner* v. *Covington*, *supra*. It is obvious that the contracts were not property of a character which is subject to the statutory allowance for depreciation, and we do not understand petitioners to so contend. The contracts were held by the partnership for less than 18 months. It follows, therefore, that the loss of $95,750 was a short term capital loss, unless it resulted from a true hedge as that term is commonly and usually understood. That brings us to petitioners' alternative contention that the loss was an ordinary and necessary business expense, because it was incurred in hedging operations.

It has long been the practice of the Commissioner and the courts to treat losses from hedging transactions as essentially insurance and deductible as ordinary and necessary business expense rather than losses from dealings in capital assets. See G. C. M. 17322, C. B. No. XV-2, p. 151; *Ben Grote*, 41 B. T. A. 247; *Commissioner* v. *Farm-*

ers & Ginners Cotton Oil Co., 120 Fed. (2d) 772; *Kenneth S. Battelle*, 47 B. T. A. 117. "Losses from true hedges are allowed in full." *Commissioner* v. *Farmers & Ginners Cotton Oil Co., supra.* In that case the Fifth Circuit also said:

"A hedge is a form of price insurance; it is resorted to by business men to avoid the risk of changes in the market price of a commodity. The basic principle of hedging is the maintenance of an even or balanced market position. To exercise a choice of risks, to sell one commodity and buy another, is not a hedge; it is merely continuing the risk in a different form. * * *"

In G. C. M. 17322, *supra*, relating to the treatment of hedging transactions for Federal income tax purposes, after describing the hedging customs of a certain cotton textile manufacturer, it is said:

"Such hedges, which eliminate speculative risks due to fluctuations in the market price of cotton and thereby tend to assure ordinary operating profits, are common trade practices and are generally regarded as a form of insurance (the only kind available as protection against such risks) necessary to conservative business operation.

"Where futures contracts are entered into only to insure against the above-mentioned risks inherent in the taxpayer's business, the hedging operations should be recognized as a legitimate form of business insurance. As such, the cost thereof (which includes losses sustained therein) is an ordinary and necessary expense deductible under section 23 (a) of the Revenue Act of 1934 and corresponding provisions of prior Revenue Acts. * * *"

Petitioners contend that the partnership's situation relative to the futures contracts was similar to the situation relative to the "futures transactions (short) in *cotton* during 1936" in *Kenneth S. Battelle, supra.* We fail to

see any similarity between the two situations. It is true that on its books of account the partnership on December 31, 1940, charged the loss of $95,750 to "Woolens Purchases" and credited E. A. Pierce & Co. with a like amount, with the explanation: "Cost of hedgings to protect purchases of woolens."

Petitioner was and is a manufacturer of men's suits from piece goods purchased from worsted mills. The partnership sold its finished products to retailers who were contracted seasonally by its various salesmen. There is no evidence that petitioner used a method of hedging against present sales of its clothing suits by the purchase of future wool tops contracts. On the contrary, the evidence seems to show conclusively that the purchase of the 100 wool tops contracts in September 1939, which it disposed of in February 1940, was not a balancing transaction against sales of clothing, but was an isolated transaction and one made because of the more or less panicky condition which arose after the outbreak of the war in September 1939 respecting the future supply of woolen piece goods. The transaction turned out badly for petitioner and the loss which it suffered could be carried over as an ordinary business net loss and used as a deduction in the next taxable year were it not for the provisions of the statute which we have quoted in the margin. In view, however, of the statutory definition of capital assets, we feel we must hold that the wool tops contracts were capital assets and that the partnership's transactions in these contracts did not represent hedging transactions as that term is ordinarily understood, and petitioners' loss in the transactions must be adjudged a short term capital loss. *Commissioner* v. *Farmers & Ginners Cotton Oil Co., supra.* Certainly, in the latter case, the transactions of the taxpayer more nearly resembled a true hedge than those of the instant case, yet the court held against the taxpayer.

It follows from what we have said that the respondent's several determinations in these consolidated proceedings must be sustained and that petitioners are not entitled to deduct from their 1941 income any net operating loss carry-over on account of the partnership's wool tops futures contracts.

Reviewed by the Court.

Decisions will be entered for the respondent.

OPPER, *J.*, dissents.

[*Dissenting Opinion*]

SMITH, *J.*, dissenting: The partnership of S. Makransky & Sons, Inc., had a loss in 1940 from the sale of certain contracts for the purchase of wool tops for delivery at a future date. It apprehended, due to war conditions, that it would be unable to secure woolen cloth for its requirements for the manufacture of men's suits. To insure itself a supply of such cloth it purchased the contracts in question. Early in 1940 it was apparent that the apprehended scarcity would not materialize; also that the wool tops which might be delivered to it under its contracts would be of an inferior grade. This being so, it sold its future contracts in February 1940, sustaining a loss upon the transaction of $95,750. The opinion of the Tax Court is that the loss is not a legal deduction from gross income upon the ground that it was a short term capital loss and that, since the partnership had no short term capital gains, the deduction of the loss must be disallowed.

It seems to me that the result is unjustified. It certainly should not be reached unless the wording of the statute requires it. Clearly, the investment in the wool tops futures was an ordinary business operation. At the time the contracts were purchased the partnership

expected to take delivery of the wool tops. It was simply insuring itself against an apprehended scarcity of material. If the partnership had taken delivery under its contracts and then sold the woolen tops there would be no question, I think, but that the loss which might have been sustained would be a legal deduction from gross income.

The situation is comparable to that of a corporation which contracts for the purchase of automobile trucks or other machinery to be delivered in the future. Before the time for delivery the corporation finds that it can purchase its requirements of trucks and machinery from another source possibly more advantageously. It therefore gives a certain amount for the rescission of its contract or sells its right for the delivery of the machinery to other parties at a loss. It would seem to me that in such a situation the claimed deduction would be an ordinary and necessary business expense. Every consideration of justice and fair play as between the taxing authority and the taxpayer argues for the allowance of the deduction. It seems to me that it is highly hypertechnical to disallow the deduction as an ordinary and necessary expense.

The Tax Court rejects the petitioners' claim that the amount is deductible as an ordinary and necessary expense. It then says that the amount cannot be deducted at all because it was a short term capital loss against which the petitioner had no short term capital gains for the year 1940. It says that the loss did not arise from a hedging transaction and that therefore the loss may not be deducted, in accordance with *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 Fed. (2d) 772; certiorari denied, 314 U. S. 683. In that case it was held that where a dealer in cottonseed oil bought refined oil futures because it had insufficient storage facilities for crude oil and had been compelled to sell crude oil at unsatisfactory prices, it merely exchanged its market risk from crude to

refined oil, and losses were not deductible in their entirety in computing income tax, since they did not result from true "hedges," notwithstanding price relation between crude and refined oil. The court found:

"* * * Petitioner could have demanded delivery of refined oil under any futures contract, but made no such demand, and the contracts were entered into by it with the intention not to demand or receive such delivery. * * *"

The facts in that case were somewhat different from those which obtain in the instant proceeding; for here the partnership did intend to take delivery upon the wool tops at the time it purchased the futures contracts.

In the above referred to case the Tax Court decided that the taxpayer was entitled to deduct its loss. 41 B. T. A. 1083. Our decision in that case was reversed by a divided court. The Supreme Court denied a writ of certiorari. But the Supreme Court has many times said that the denial of a writ of certiorari is not tantamount to the affirmance of the decision of the lower court.

It may at once be admitted that an ordinary hedging transaction is one where a person attempts to hedge against a loss by the purchase or sale of a future contract on the stock exchange or a commodity exchange. But I do not think that a hedging contract should be limited to that defintion. The partnership with which we are here concerned attempted to hedge against a loss in business operations for 1940 by securing for itself a supply of wool tops from which it could have cloth for the manufacture of men's suits. That seems to me to be as much a hedging contract as one where the contract is simply to protect one's self against a fluctuation in price. It seems to me that it was in essence a hedging contract.

Furthermore, I do not think that the definition of capital gains was ever intended to apply to a contract of this character. To be sure the partnership when it purchased

the future contracts in 1939 had a species of property. It had an investment in the contracts and, undoubtedly, at some time after the purchase it could have sold those contracts to recover back at least a part of the amount it had invested in them.

The situation here seems to me to be comparable to that which obtained in *Palmer v. Commissioner*, 302 U. S. 63. In that case the taxpayer had received warrants from the American Superpower Co. entitling him to purchase from it shares of stock in other corporations which it owned. The rights had a large market value at the time they were received by Palmer. He exercised the rights and acquired the shares. The Commissioner determined that Palmer received taxable income by the receipt of the warrants to the extent of their value. The Board of Tax Appeals reversed his determination and that reversal was sustained by the Supreme Court. That Court simply gave a sensible construction to the statute and held that Palmer did not derive taxable income merely from the receipt of the warrants.

So here, I think that we should give a sensible construction to the statute and hold that the net income of the partnership for 1940 was what remained after the deduction of the loss sustained on the sale of the future contracts for the purchase of the wool tops.

LEECH, *J.*, dissenting: In general I agree with the foregoing dissent. Since some of my reasons for dissenting may be different, it may be well to state them.

The propriety of the disputed "net operating loss carryover" turns on the deductibility of a very real loss petitioners sustained in the transaction in wool "futures." Sec. 122, I. R. C. This loss, if deductible at all, must be so as a "hedge" and therefore a business expense, or as an ordinary loss. The majority holds it is neither. I disagree.

Appendix C

Futures transactions, in order to be classified as a true "hedge," need not occur in any particular step of the business cycle in which the taxpayer is engaged. The term means a form of insurance of the profits of a business. So, if the "futures" were purchased by the partnership to insure the profitable conduct of any step in *its* business, they were a true "hedge." See *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 Fed. (2d) 772; certiorari denied, 314 U. S. 683.

The majority opinion is premised upon, *inter alia*, the following finding of fact:

> The partnership purchased the 100 contracts for the future delivery of wool tops as a means of acquiring the wool tops and with the intention and purpose of taking delivery of the wool tops for manufacture into piece goods which they would use in their business of manufacturing men's suits.

This finding affords substantial, if not incontrovertible, proof of the fact that the purchase of the "futures" here was not in reality a purchase of "futures contracts" at all, but rather the first step in the actual and intended purchase of the wool itself for future delivery. If so, this wool would have been excluded from "capital assets" by the first exception in the definition of that term appearing in section 117 (a) (1) of the Internal Revenue Code, and its sale would have resulted in an ordinary and not a capital loss.

In my opinion, the transaction in "futures" here was either a true "hedge" or resulted in an ordinary loss. In either event the amount of this actual loss was deductible in the computation of the "net loss carry-over." The case of *H. Elkan & Co.*, 2 T. C. 597, if not distinguishable on the facts, I think should be overruled.

MELLOTT, *J.*, agrees with this dissent.

Appendix C

FARMERS & GINNERS COTTON OIL COMPANY, PETITIONER, v. COMMISSIONER OF INTERNAL REVENUE

Docket No. 93436, March 3, 1942.

Lee C. Bradley, Jr., Esq., for the petitioner.

Claude R. Marshall, Esq., for the respondent.

MEMORANDUM OPINION

MURDOCK:

The decision of the Board pursuant to its findings of fact and opinion published at 41 BTA 1083 was reversed by the United States Circuit Court of Appeals for the Fifth Circuit. A mandate simply reversing the decision of the Board has been received. The Board placed the proceeding upon its calendar on a certain day and directed the parties on or before that time to submit computations of the tax liability of the petitioner consistent with the opinion of the Court or otherwise move with respect to the case. The Commissioner submitted a computation, and the petitioner filed a motion asking the Board "to find appropriate facts with respect to the question whether contracts for the purchase of refined cottonseed oil or the refined cottonseed oil to be purchased pursuant thereto are property of a kind which should properly be included in the inventory of the Petitioner if on hand at the close of the taxable year, and to enter its decision after consideration of the question involved and in the light of the finding so made." The findings of fact which appear in the report of the Board contain all of the facts that the record justifies in regard to the contracts for the future delivery of refined cottonseed oil. The petitioner is claiming now, as it claimed previously, that those con-

tracts were property of a kind which properly should be included in inventory if on hand at the close of the taxable year. That question was not decided by the Board or the Appellate Court, and therefore, it must be considered and decided now.

The petitioner purchased futures in refined cottonseed oil, that is, it purchased contracts for the delivery of refined cottonseed oil at some specified date in the future. It made the purchases on margin. It had no customers of its own in respect to the sale of the futures contracts and those contracts were neither stock in trade nor property held by the petitioner primarily for sale to customers in the ordinary course of its trade or business. These matters are all set forth in the prior report of the Board. The petitioner still contends that the contracts were inventoriable. It relies upon various rulings and several court cases, but those rulings and court cases are distinguishable on their facts. Owners actually dealing in a commodity which is being held for them in a warehouse have been allowed to inventory the commodity. Heiner v. Mellon, 304 U. S. 271; Roney v. Commissioner, 67 F. (2d) 165. Cf. G. C. M. 1582, VI-1 C. B. 171. They were the owners of the goods in question at the end of the year. The petitioner in this case, at the end of the year, would have had merely a contract for delivery at some future time. The goods involved in that contract might not even be in existence at the end of the year. The petitioner was not in fact dealing in the commodity covered by the contracts. George W. Covington, 42 BTA 601, affirmed on this point 120 F. (2d) 768. G. C. M. 18658, C. B. 1937-2, p. 77 permits goods on hand to be inventoried by persons in a position similar to that of dealers. That ruling does not apply to this petitioner.

G. C. M. 17322, XV-2 C. B. 151 is to the effect that the capital gain and loss provisions apply to all futures contracts that are speculative, as distinguished from true

hedges. The Circuit Court has held that the transactions of this petitioner were not true hedges. Thus, the memorandum referred to supports the Commissioner rather than the petitioner. The case most nearly in point is likewise against the petitioner. Staerker, Admr., v. United States, an unreported decision of the District Court for the Northern District of Texas, handed down on December 23, 1938 and appearing in 23 AFTR 1284. It is our opinion that the futures would not have been inventoriable by the petitioner if on hand at the end of the year. A decision will be entered in accordance with the computation filed by the respondent.

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, v. FARMERS & GINNERS COTTON OIL COMPANY, RESPONDENT

United States Circuit Court of Appeals for the Fifth Circuit.

No. 9802. Filed June 9, 1941.

Petition for Review of Decision of the United States Board of Tax Appeals (District of Alabama).

Edward H. Hammond and Sewall Key, Sp. Assts. to Atty. Gen., Samuel O. Clark, Jr., Asst. Atty. Gen., and J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and C. R. Marshall, Sp. Atty., Bureau of Internal Revenue, all of Washington, D. C. for petitioner.

Lee C. Bradley, Jr., and A. J. Bowron, Jr., both of Birmingham, Ala., for respondent.

Before Foster, Hutcheson, and Holmes, Circuit Judges.

Appendix C

HOLMES, *Circuit Judge.*

The question for our decision is whether losses which the taxpayer sustained on contracts for future deliveries of refined cottonseed oil were capital losses under Sec. 117(d) of the Revenue Act of 1934, 26 U. S. C. A. Int. Rev. Acts, page 708, or ordinary and necessary business expenses under Sec. 23(a) of said act, 26 U. S. C. A. Int. Rev. Acts, page 671.

The respondent taxpayer is a corporation. It buys cottonseed, crushes it, and sells the products derived therefrom. One of such products is crude cottonseed oil, which deteriorates rapidly, especially in warm weather. The respondent's storage facilities for crude oil are not more than one-sixth of its annual production, and larger storage facilities would be uneconomical. Because of these circumstances, respondent does not retain its crude oil until it can obtain what it regards as a favorable price, but sells during the operating season at the market price whenever its storage tanks are full. When forced to sell its crude oil at prices which it deems unsatisfactory, it is respondent's practice to buy, on margins, refined oil for future delivery, which later it sells before the delivery date.

There is no futures market for crude oil, but there is a direct relationship in the market price between the crude and the refined oil. The market price of the former is determined in large part by the market price of the latter plus freight to the refinery, the cost of refining, the loss in refining, and such other expenses, if any, as are incident to the operation of converting crude into refined oil. The customary practice followed by respondent during the tax year was first to sell the crude oil at the prevailing market price, and then to place orders with brokers to purchase futures on a produce exchange. If orders could not be filled readily at the price designated by respondent,

the orders were carried until purchases could be made at such prices. Such purchases were sometimes made weeks later than the corresponding sales of crude.

Crude oil loses about nine per cent in weight in the process of being refined. In the fiscal year ending June 30, 1936, petitioner sold 2,940,000 pounds of crude oil at prices unsatisfactory to it, and made purchases of 2,760,000 pounds of refined-oil futures. 2,760,000 pounds of refined oil is the approximate equivalent in pounds of 3,033,000 pounds of crude oil. The quantity unit, both in the transactions in crude and refined oil, is a tank of 60,000 pounds. During the taxable year the market price of crude oil averaged approximately nine cents a pound, or $5,400 per tank. Refined-oil futures were bought on margins of about $300 per tank. Petitioner could have demanded delivery of refined oil under any futures contract, but made no such demand, and the contracts were entered into by it with the intention not to demand or receive such delivery. Its transactions in this respect consisted entirely of purchases and sales of refined oil for future delivery, the contracts for which were terminated before the date agreed upon for delivery. Futures contracts for refined oil require no investment for storage, transportation, or insurance. Accordingly, about $300 per tank plus brokerage commissions constituted petitioner's initial investment under the futures contracts.

The Board found that transactions in such commodity for future delivery were entered into by respondent solely as a protective measure against sales of crude oil which it was compelled to make at prices deemed unsatisfactory, since it was able to maintain a position in respect of future market conditions of refined oil which it was powerless to maintain in respect of crude oil; that such futures contracts were bought and sold only on produce exchanges through brokers, and that petitioner had no customers of its own in respect thereof; that such contracts were not

stock in trade, and were not property held by respondent primarily for sale to customers in the ordinary course of its trade or business.

In the taxable year, petitioner sustained a loss of $24,024 in its transactions in refined oil, bought and sold for future delivery, and deducted the amount of such loss from its gross income. The petitioner contends that the losses in question resulted from the sale of capital assets, and disallowed as a deduction so much thereof as exceeded $2,000 plus capital gains. Respondent contends that the losses it sustained in such dealings in refined oil were normal business losses. The claim is based primarily on the hypothesis that the initial processing of raw cottonseed is so related to the manufacture of refined cottonseed oil as to make stocks of the latter product invoiceable as regular "stock in trade" of the processor. Secondarily, it contends that, in any event, its dealings in oil futures were transactions entered into for profit, and that the resulting losses are deductible, under Sec. 23(f) of the Revenue Act of 1934, as having been sustained during the taxable year and not compensated for "by insurance or otherwise."

(1,2) The petitioner concedes respondent's loss, but contends that its investments in refined oil for future delivery were capital assets within the definition set out in paragraph (b) of Sec. 117 of the Revenue Act of 1934. Losses on commodity exchanges from dealings such as these may be said to fall into three general classes: hedges, wagering contracts, and legitimate capital investments.[1] Losses from true hedges are allowed in full.[2] Wagering losses are allowed only to the extent of gains

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[1] United States v. Coffee Exchange, 263 U. S. 611, 619, 44 S. Ct. 225, 68 L. Ed. 475.

[2] Grote v. Commissioner, 41 B.T.A. 247.

from wagering contracts.[3] Capital losses are allowed only to the extent of $2,000 plus the gains from sales or exchanges.[4] In this case[5] the Board allowed the full amount as true hedging losses, citing its decision in Grote v. Commissioner, supra. There is no claim that these were wagering contracts; it would not help respondent if they were; and the presumption is that they were not. We have this day held that losses from executory commodity futures-contracts were capital losses.[6] Therefore, we need only examine the contention of the taxpayer, which was upheld by the Board, that the losses in controversy resulted from true hedges.

(3) A hedge is a form of price insurance; it is resorted to by business men to avoid the risk of changes in the market price of a commodity. The basic principle of hedging is the maintenance of an even or balanced market position. To exercise a choice of risks, to sell one commodity and buy another, is not a hedge; it is merely continuing the risk in a different form. That is what the taxpayer did in this case. It did not retain its crude oil and sell refined; it sold crude and bought refined when it had no actual commodity on hand or future commitments to be protected from price variations.

(4) Conceding that there is a price relation between crude and refined oil, the respondent merely exchanged its market risk from crude to refined. It may have sold crude at prices which were unsatisfactory to it, but the purchase of refined gave it no price insurance against future fluctuations in the market. The respondent was

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[3] Sec. 23(g), Act of 1934, 48 Stat. 689, 26 U. S. C. A. Int. Rev. Acts, page 672.

[4] Sec. 117(d), Act of 1934, 48 Stat. 715, 26 U. S. C. A. Int. Rev. Acts, page 708.

[5] 41 B.T.A. 1083.

[6] Commissioner v. Covington, et al., 5 Cir., 120 F. 2d 768, decided June 9, 1941.

not a manufacturer of refined oil. It had no crude or refined oil on hand when it bought or sold the futures from which the losses in controversy were incurred. These losses did not result from true hedges, and the decision of the Board of Tax Appeals is reversed.

HUTCHESON, *Circuit Judge*, dissents.

FARMERS & GINNERS COTTON OIL COMPANY, PETITIONER v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 93436. Promulgated May 8, 1940.

CAPITAL ASSETS-HEDGING.—Purchases and sales of refined cottonseed oil futures by a manufacturer of crude cottonseed oil made entirely as a hedge or protection against the forced sale of perishable crude cottonseed oil at unsatisfactory prices, *held*, to relate directly to its business of the manufacture and sale of crude cottonseed oil, and losses sustained in such transactions were not capital losses subject to the deduction limitation of section 117 of the Revenue Act of 1934.

E. L. All, Esq., *A. J. Bowron, Jr., Esq.*, and *Virden Moore, Esq.*, for the petitioner.

Stanley B. Anderson, Esq., for the respondent.

The Commissioner determined a deficiency of $3,019.05 in the petitioner's income tax for the fiscal year ended June 30, 1936. The issue for decision is whether losses of $24,024.30 which the petitioner sustained on contracts for future deliveries of refined cottonseed oil were capital losses subject to the $2,000 limitation of section 117 of the Revenue Act of 1934, or whether they were ordinary losses or ordinary and necessary business expenses deductible in their entirety.

Appendix C

FINDINGS OF FACT.

The petitioner is a corporation, organized under the laws of Alabama. Its principal office is in the city of Birmingham.

It is engaged in the business of operating a cottonseed oil mill. That is, it buys cottonseed, crushes the seed, and sells the products derived therefrom, consisting of crude cottonseed oil, meal, linters, hulls, fibers, and bran. The crude cottonseed oil is perishable and deteriorates rapidly, especially in warm weather. The crude oil storage facilities of the petitioner held not more than one-sixth of the annual production of the mill. Larger storage facilities were impractical not only because of the expense but also because the oil would deteriorate if held. The petitioner, because of these circumstances, could not retain its crude oil until it could obtain what it regarded as a favorable price, but had to sell during the operating season at the market price whenever its storage tanks were full.

The practice of the petitioner has been to buy futures in refined oil when, but only when, it was forced to sell crude at prices which it regarded as unsatisfactory. Refined cottonseed oil may be kept for long periods and has a market throughout the year on produce exchanges. There is a direct relationship between the market price of refined oil and the market price of crude oil as of any given date. The petitioner purchased quantities of refined oil for future delivery only to offset the sale of like quantities of crude at prices which it regarded as unsatisfactory. It would first sell the crude at prevailing market price and then place orders with brokers for the purchase of refined futures at prices named by the petitioner. Sometimes several weeks would intervene before the purchases could be made at the prices named. The practice of buying futures was generally followed by others engaged in the same line of business as the petitioner.

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The petitioner sold 2,280,000 pounds of crude during the taxable year at prices satisfactory to it and made no offsetting purchases of futures in regard to those sales. It sold the following quantities of crude on the dates mentioned at prices unsatisfactory to it:

Date	Pounds
10/16/35	180,000
10/16/35	420,000
10/18/35	60,000
10/22/35	300,000
10/22/35	180,000
10/25/35	60,000
10/28/35	180,000
10/30/35	360,000
11/20/35	300,000
12/ 6/35	180,000
12/ 6/35	120,000
1/ 8/36	600,000

It purchased futures of refined to offset those sales, and its dealings in those futures are shown in the following table:

Date Acquired	Date Sold	Quantity Pounds	Losses
11/22/35	4/13/36	180,000	$2,462.13
11/22/35	4/13/36	120,000	1,653.42
11/26/35	4/13/36	180,000	2,336.13
11/26/35	4/13/36	120,000	1,545.42
1/ 9/36	4/13/36	300,000	1,328.55
1/ 9/36	4/13/36	180,000	887.13
1/ 9/36	4/13/36	120,000	615.42
1/ 9/36	4/13/36	120,000	639.42
1/ 9/36	4/13/36	180,000	959.13
2/ 7/36	4/13/36	60,000	331.71
2/ 7/36	4/13/36	300,000	1,658.55
12/12/35	4/13/36	120,000	1,521.42
12/12/35	4/13/36	60,000	736.71
12/17/35	4/18/36	120,000	1,389.42
12/17/35	4/21/36	60,000	766.68
12/19/35	4/21/36	60,000	766.68
12/20/35	4/21/36	120,000	1,545.36
12/28/35	4/21/36	60,000	772.68
1/ 9/36	6/25/36	300,000	2,108.34
Total		2,760,000	$24,024.30

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The petitioner bought the futures on margin. The quantity unit in transactions in crude and refined oil is a tank of 60,000 pounds. The rules of the exchange on which the futures were purchased provide that purchases "of commodities for future delivery are made with the distinct understanding that actual receipt and/or delivery is intended", but the petitioner never took delivery of any of the refined. Instead, it sold its contracts for future delivery.

The practice of buying features was a more efficient and less expensive way for the petitioner to await more favorable markets than the alternative of having its crude oil manufactured into refined and held in storage as its own property. Purchase of cottonseed was not a practical method of protecting the petitioner against sales at unfavorable prices.

The petitioner entered into the transactions in futures solely as a protection against sales of crude oil which it was compelled to make at prices which it deemed unsatisfactory, and those transactions enabled it to maintain a position in respect to future market conditions of refined oil which it was powerless to maintain in respect to crude oil.

The futures were bought and sold by the petitioner only on the New York Produce Exchange, through brokers. The petitioner had no customers of its own in respect thereto. The contracts were neither stock in trade nor property held by the petitioner primarily for sale to customers in the ordinary course of its trade or business.

The petitioner on its income tax return for the taxable year claimed deductions for the losses sustained in its transactions in futures. The Commissioner held that the losses resulted from sales of capital assets and limited the deduction to $2,000.

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OPINION.

MURDOCK: The question here is substantially the same as that considered in the case of *Ben Grote*, 41 B. T. A. 247. The only purpose which the petitioner had in buying the futures in refined oil was to attempt to avoid loss upon the crude oil which it was manufacturing. This method was as effective a hedge against loss on its operations as was available to the petitioner. Its raw material was cottonseed, but there was no futures market for that and no hedge could be made by purchases thereof. It did not buy the futures merely as a speculation, but solely to replace its manufactured product which it was forced to sell at a price which it deemed unsatisfactory. All of the transactions were directly related to its business of production and sale. The question of whether or not it could have inventoried the contracts for future delivery of refined oil need not be decided. Cf. G. C. M. 18658, C. B. 1937-2, p. 77. We pointed out in the *Grote* case that the Commissioner has interpreted and administered section 117 as excluding hedging transactions, citing G. C. M. 17322, C. B. XV-2, p. 151. The facts in this case disclose no satisfactory basis for distinguishing it from the *Grote* case and on that authority we hold that the petitioner is entitled to a deduction of $24,024.30 as losses sustained in connection with its business for the taxable year.

This opinion supersedes that promulgated on February 6, 1940, 41 B. T. A. 255.

Reviewed by the Board.

Decision will be entered under Rule 50.

HILL, dissenting: I am unable to agree with the conclusion reached in the majority opinion. The business

of petitioner was the operation of a cottonseed oil mill. That business was confined to buying and crushing cottonseed and selling the products derived therefrom, including crude cottonseed oil. Petitioner's business did not include the processing of crude into refined oil. Its dealings in futures contracts for refined oil were transactions involving mere investment in, and sale of, capital assets having no identity with the products manufactured by petitioner. Refined oil is a distinct and separate commodity from crude oil, notwithstanding the latter is an intermediate source of the former. The manufacturing operations of petitioner did not extend to the production of refined oil and its business operations were completed when it sold the products it manufactured.

Petitioner contends that the initial processing of crude oil is so related to the manufacture of refined oil as to make stocks of the latter product invoiceable as regular "stock in trade" of the processor. It further contends that its transactions in refined oil futures were essentially a part of a process of production or other acquisition of property for sale to customers in the ordinary course of its trade or business.

The first of these contentions has no factual basis of application in this proceeding. Petitioner had no refined oil to invoice either as stock in trade or otherwise and the evidence herein discloses that its intention in dealing in refined oil futures was not to take delivery of oil, notwithstanding it could have demanded and received delivery under the terms of the futures contracts. Its transactions in refined oil futures were merely executory contracts to purchase, which it acquired with a positive intent not to close into completed purchases and not to acquire any commodity thereby.

The second of the above cited contentions of petitioner is (a) that its transactions in refined oil futures were a part of a process of production or (b) other acquisition

of property for sale to customers in the ordinary course of its trade or business. As to subdivision (b) of this contention, attention is directed to the fact that by the purchase of such futures contracts the only property acquired was the contracts, which were bought and sold through brokers on petitioner's own account only and not for customers. They were merely choses in action and represented neither stocks of oil nor any other commodity includable in an inventory of stock in trade. By subdivision (a) of such second contention petitioner obviously means that its transactions in refined futures contracts were a part of the process of production of crude oil. The gist of its supporting argument on this point is that transactions in such futures contracts were necessary to enable petitioner to maintain its position in the oil market, due to the fact that rapid deterioration of crude oil compels its sale shortly after production, regardless of the state of the market. Since, as is found, there is a direct relationship between the market price of crude and refined oil, the purpose of petitioner in maintaining a position in the oil market by purchasing refined oil futures is to enable it to indulge in the speculation that at some future time there may be a better market for oil than when it sold crude. Such speculation also involves, of course, the risk that instead of improving, the market price may descend to a still lower level. If, as is argued for petitioner, its purpose in buying refined oil futures was to maintain the same position it would have had in the oil market if it had not been forced to sell its crude oil on an unsatisfactory market, it failed to accomplish that purpose.

The purchasing of futures contracts at or following the times of corresponding sales of crude oil did not operate as an unbroken maintenance of petitioner's position in the oil market. It left a hiatus between the dates of sales of crude oil and the delivery dates of the futures con-

tracts. Hence, it can not be said that the futures contracts accomplished the purpose which petitioner acclaimed, namely, to maintain its position in the oil market. That purpose could have been effectuated by purchasing spot refined oil at the related market prices at the times of corresponding sales of crude oil and by adding such refined oil to its inventories and to its stock in trade for sale to its customers in the ordinary course of trade or business. That, however, would not have been insurance or protection against investment risks. It would have afforded only an opportunity for speculation on future oil prices. But such stocks of refined oil would not have been within the classification of capital assets and any losses resulting in respect thereof would have been deductible in full for income tax purposes. This course would have at least continued petitioner's status in the oil market on the same relative price basis as if it had been able to hold its crude oil. Since petitioner did not adopt this course it can not successfully contend that its purpose was to replace crude oil with refined oil. Petitioner did not seek to maintain its position in the oil market through the replacement of inventories of crude oil with those of refined oil but first closed out its investment in its crude oil inventories and thereafter made corresponding purchases of refined oil futures contracts which bore no protective relationship to any existing or prospective investment risk. Furthermore, the market prices at which the futures contracts were purchased were the then present prices of future deliveries and had no relation to the market prices at which the corresponding sales of crude oil were made. The purchases of such futures contracts were, therefore, wholly speculative transactions. In view of the purely speculative character of all transactions in futures contracts (except as hedges), it appears to me that, unless such futures contracts constitute hedges against petitioner's business investment

risks, they can not be said to be a part of petitioner's process of production.

Petitioner does not claim that its transactions in futures contracts possessed all of the elements of a hedge, but it claims that they had a protective purpose and relationship to its business and operations. It is my opinion that such transactions had none of the elements of a hedge and in no way afforded insurance or protection against petitioner's existing or prospective investment risks, either in its raw materials or its crude oil. The purchase of such futures contracts operated only to create new and additional investments, fraught with new and additional investment risks, without any counterbalance of a hedge.

The statute has no provision excluding hedging transactions from the operation of the provisions of section 117 of the Revenue Act of 1934, but the Treasury Department has construed such section as excluding from its operation hedging transactions. G. C. M. 17322, C. B. XV-2, p. 151. The discussion and illustration of hedges set forth therein do not include, as constituting a hedge, the state of facts in the instant proceeding. Two examples are given therein as illustrating typical situations in which protection is obtained by the use of hedging transactions, as follows:

(1) The taxpayer buys quantities of spot cotton, which will necessarily be on hand for some months before being manufactured into goods and sold. In order to be protected against losses which would be incurred if the cotton market declined during those months, the taxpayer, at the same time the above purchases are made, enters into futures sale contracts for the delivery of equivalent amounts of cotton a few months hence. As the above quantities of spot cotton are subsequently disposed of by sales from time to time of manufactured cotton goods, the above futures sale contracts are con-

currently disposed of by futures purchase contracts which serve as offsetting transactions closing out the futures sale contracts.

(2) The taxpayer makes contracts for future delivery of cotton goods, the manufacture of which will require more cotton than the amount on hand or the amount which can be immediately purchased advantageously. In order to secure protection against a rising cotton market during the months that intervene between the date of the order for cotton goods and the agreed delivery date, the taxpayer, at the same time the above orders are taken, enters into futures purchase contracts for cotton in amounts necessary to provide the desired protection. As the taxpayer from time to time buys spot cotton for the manufacture of the goods specified in the above orders, the futures purchase contracts are disposed of by futures sale contracts which serve as offsetting transactions closing out the futures purchase contracts.

* * * *

The last paragraph of the cited G. C. M. is as follows:

It follows from the above that hedging transactions are essentially to be regarded as insurance rather than a dealing in capital assets within the comprehension of section 117 of the Revenue Act of 1934. Regardless of accounting or inventory methods in use, provisions pertaining to capital gains and losses govern gains or losses on futures contracts which are speculative. Futures contracts representing true hedges against price fluctuations in spot goods are not speculative transactions, though not concurrent with spot transactions. Futures contracts which are not hedges against spot transactions are speculative unless they are hedges against concurrent futures or forward sales or purchases.

Under the interpretation set forth in the cited G. C. M.

the futures contracts in the instant proceeding would not be includable in petitioner's inventories if on hand at the end of the taxable year, for the reason that they are not hedges against actual spot or cash transactions or against forward sales or purchases, as evidenced by a quotation with approval therein from S. M. 5693 (C. B. V-2, p. 20) as follows:

(2) That cotton and grain dealers should incorporate in their balance sheets at the close of the taxable year at market such open future contracts to which they are parties as are hedges against actual spot or cash transactions or against forward sales or purchases, as the case may be; provided, that no purely speculative transactions in futures not offset by actual spot or cash transactions or concurrent forward purchases or sales may be so included or taken into the taxpayer's account in any manner until such transactions are actually closed by liquidation; and provided further, that the values of the commodity covered by such open future contracts shall not be added to or deducted from the inventory of the taxpayer.

In order for petitioner to avail itself of the protective principle of a hedge as that principle is illustrated and enunciated in the cited G. C. M., it must use as a basis the investment risk involved in the cost of its raw material, namely, cottonseed, and relate its futures purchases to that basis. After the manufacturing processes are complete and the resulting product sold, there remains no investment risk against which to hedge.

It is my opinion that petitioner's dealings in futures contracts were not in any sense hedging transactions, and by the very circumstances under which they were consummated they could not possibly be other than purely speculative and could not furnish protection against petitioner's business or investment risks. A hedging transaction is not speculative and eliminates *pro tanto* the speculative character of the investment hedged. It

operates as insurance or protection against the investment risk of future loss and must be entered into for operation covering the period of such risk and terminate therewith. A hedging transaction and the investment protected thereby coexistingly operate upon each other. If a gain is realized on the hedging transaction it is counterbalanced either by a realized loss or by some other character of economic disadvantage in respect of the investment hedged. If a loss is realized in the former it is counterbalanced by a realized gain or some other character of economic advantage in respect of the latter. As a result of the counterbalancing effect between the hedging transaction and the investment protected thereby, speculation as to either gain or loss is eliminated.

It is said in the majority opinion:

> * * * The only purpose which the petitioner had in buying the futures in refined oil was to attempt to avoid loss upon the crude oil which it was manufacturing. This method was as effective a hedge against losses on its operations as was available to the petitioner. * * *

It is my opinion, as hereinabove pointed out, that it was not a hedge and was not of such character as to be effective to accomplish petitioner's claimed purpose. If, however, petitioner's transactions in refined oil futures contracts be deemed a hedge for tax purposes, petitioner with equal logic and effectiveness could have created a hedge by purchasing wheat futures contracts or futures contracts in respect of any other commodity listed on the produce exchange. This illustration is employed merely to indicate the wide open spaces revealed in the majority opinion. The opinion of the Board in this proceeding cites the case of *Ben Grote*, 41 B. T. A. 247, as authority for its conclusion. Regardless of whether the *Grote* case, on its facts, supports the conclusion reached by the majority in this case, it is my opinion that the *Grote* decision is glaringly erroneous. I dissented from it. The opinion

in the *Grote* case did not discuss the question of what constitutes "hedging transactions." It merely said "the evidence shows that petitioner's transactions were all hedging transactions." Aside from that terse *ipse dixit*, no reasons are assigned for the conclusion therein reached.

Subdivision (a) of section 117, *supra*, defines as "capital assets" all property held by a taxpayer except (1) stock in trade of the taxpayer, (2) other property which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, and (3) property held by the taxpayer primarily for sale to customers in the ordinary course of business.

Regardless of whether petitioner's transactions in such futures contracts constituted a trade or business or were entered into for profit, such contracts were nevertheless capital assets within the above statutory definition. They were choses in action, bought and sold only on a produce exchange through brokers. They were bought and sold by petitioner on its own account only, and not for customers. It held no oil futures contracts in stock for sale to customers and, therefore, had no right to include them in an inventory. Cf. *Francis M. Weld*, 31 B. T. A. 600; *Adirondack Securities Corporation*, 23 B. T. A. 61; *Oil Shares, Inc.*, 29 B. T. A. 664; *O. L. Burnett*, 40 B. T. A. 605; *Staerker v. United States* (U. S. Dist. Ct., N. Dist. of Texas, Sept. 23, 1938).

Accordingly the losses involved in this proceeding were capital losses and the deduction thereof should be limited as prescribed in subdivision (d) of section 117, *supra*.

LEECH and HARRON agree with this dissent.

MELLOTT, dissenting: The case of *Ben Grote*, 41 B. T. A. 247, which I feel was decided correctly, does not support

the conclusion of the majority in the instant proceeding. It approves an administrative ruling (G. C. M. 17322, C. B. XV-2, p. 151)—which it may be is not bottomed upon any specific statutory provision—authorizing the deduction of losses in connection with "hedging" operations as "a legitimate form of business insurance."

I agree with much that is said by Mr. Hill in his dissenting opinion. It is obvious that petitioner's dealings in futures in refined oil did not constitute true "hedging" operations in its business. Hedging "is a means by which collectors and exporters of grain or other products, and manufacturers who make contracts in advance for the sale of their goods, secure themselves against the fluctuations of the market by counter contracts for the purchase or sale, as the case may be, of an equal quantity of the product, or of the material of manufacture." *Board of Trade* v. *Christie Grain & Stock Co.*, 198 U. S. 236, 249. In *United States* v. *Coffee Exchange*, 263 U. S. 611, 619, the Court refers to one of the classes who deal in "futures" as "those who use them to hedge, i. e., to insure themselves against loss by unfavorable changes in price at the time of actual delivery of what they have to sell or buy in their business." The examples given in the G. C. M. indicate that when the Commissioner used therein the term "hedging" he had in mind the Court's definition. I would limit the applicability of the ruling to one who has made a counter contract for the purchase or sale of an equal quantity of the product manufactured or raised, or of the material going into the manufacture of it.

Appendix C

TRENTON COTTON OIL CO. v. COMMISSIONER OF INTERNAL REVENUE.

No. 9799.

Circuit Court of Appeals, Sixth Circuit.
February 8, 1945.

On Petition to Review the Decision of the United States Tax Court.

Robert P. Adams, of Trenton, Tenn. (Taylor, Adams & Freeman, of Trenton, Tenn., on the brief), for petitioner.

Helen Goodner, of Washington, D. C. (Samuel O. Clark, Jr., J. Louis Monarch, and Helen R. Carloss, all of Washington, D. C., on the brief), for respondent.

Before HICKS, HAMILTON, and McALLISTER, Circuit Judges.

HAMILTON, *Circuit Judge.*

Petitioner, a Tennessee corporation, is engaged in the business of operating a cotton seed oil mill for the production of crude cottonseed oil and by-products. Its business is seasonal manufacturing operations extending from approximately mid-September to mid-March.

Petitioner acquires the cotton seed from ginners in approximately 100-ton lots graded and carrying a base price subject to adjustment when analyzed upon delivery. It frequently makes loans to ginners in advance of the ginning season conditioned that such borrowers will offer their seed when produced to petitioner at the then market price, petitioner being under no obligation to purchase the seed. On making a firm contract for the purchase of

seed, petitioner estimates the amount of crude oil obtainable and immediately sells the oil to refiners for future delivery at a fixed price. Crude cottonseed oil deteriorates rapidly and if its value is to be preserved it must be refined shortly after production.

Petitioner's plant was not equipped for refining crude oil and its storage facilities were limited to about four and one-half tanks which furnished storage for two weeks' production only. Petitioner kept its accounts and made its income and excess profits tax returns on a fiscal year basis ending August 31st.

Petitioner was uncertain as to the amount of crude oil it could produce from the cottonseed it had contracted to buy and the price it might obtain therefor as the market was unstable. It produced sixty-seven tanks, of approximately 60,000 pounds each, during the operating season of 1938 and 1939. At the beginning of the season, petitioner's board of directors agreed that it would purchase on the Commodity Exchange tanks of refined oil equal to the number of tanks of crude oil sold on the date of the sale of the latter. During the 1938 and 1939 season, simultaneously with the sale of each tank of crude oil, petitioner purchased on margin, for future delivery a tank of refined oil, except that no offsetting purchases were made for the last nine tanks of crude oil sold.

Under the rules of the exchange, refined oil purchased on margin must be delivered within seven months from date of purchase. Petitioner did not receive any of the refined oil, but through its broker, exchanged its contracts for others maturing at a later date, thus maintaining its futures for fifty-eight tanks until September, 1939, when it sold all of them and thereafter made no futures purchases.

On its income tax return for the fiscal year ending August 31, 1939, petitioner showed a net loss of $48,062.85. In determining this loss, it claimed as a deduction

$62,400 the difference between the original purchase price of the refined oil futures and the sum it agreed to pay for replacements at the end of seven months from the date of each original purchase.

In its tax return for the fiscal year ending August 31, 1940, petitioner reported net income of $7,525.66. In determining net income, petitioner showed a profit from the sale of oil futures in the sum of $47,514 which it deducted from the $62,400 loss in the year 1939, leaving a net loss from the sale of futures of $14,886, which sum it deducted from gross income.

Respondent on audit and review determined that the loss sustained by petitioner for the fiscal year ending August 31, 1939, resulted from the sale of capital assets and was allowable only to the extent of $2,000 under Section 117(d) of the Revenue Act of 1938, 26 U. S. C. A. Int. Rev. Acts, page 389, and disallowed the entire loss claimed by petitioner for the year ending August 31, 1940, and included in gross income the entire profit realized by petitioner during the year from the sale of futures. The Tax Court sustained respondent.

The first question for decision is whether the losses sustained by petitioner from the dealings in refined cottonseed oil futures were ordinary and necessary business expenses under Section 23(a)(1) of the Internal Revenue Code, Title 26 U. S. C. A. Int. Rev. Code, § 23(a)(1), or capital losses under Section 117(d)(1) of the Code, Title 26 U. S. C. A. Int. Rev. Code, § 117(d)(1)

[1] Losses from counter contracts made by manufacturers to protect themselves against fluctuations of markets in the purchase of raw material in advance of use, or sales of manufactured goods in advance of production, are treated under the Internal Revenue Statutes as ordinary business expenses, and gains from such sources are treated as ordinary income. Ben Grote v. Com'r, 41 B. T. A. 247; G. C. M. 173.22, XV-2, Cum. Bull. 151 (1936). Purchases

and sales against price fluctuations are insurance against loss and such transactions have a direct relationship to profit realized or loss sustained in the conduct of a business.

[2] Before such a loss may become allowable as a business expense, it must be made to appear that a contract has been entered into for the sale and delivery of a product at a future date and that there is a counter contract for the purchase of the same product for future delivery or one so akin to it that it affects the price of the former. The whole theory is that when the price goes up or down the gain on one transaction will offset the loss on the other. The price relationship, as shown by the evidence, between crude and refined oil is so intimate that the purchase of the latter for future delivery may be used as an insurance against risk of loss on the former sold for future delivery and the same is true as to the price relationship between refined oil and cottonseed.

The real question here is whether petitioner's contracts for the purchase of refined oil futures were made to protect it against loss on the purchases of cottonseed or on the sale of crude oil for future delivery.

The Tax Court found as a fact that petitioner's purchases were not for that purpose. This finding is supported by substantial evidence.

Petitioner's general manager testified that there was a thorough understanding and agreement among its officers and directors that refined oil futures would be purchased and held until such time as the market might reach the point where it would be possible for petitioner to protect or recover against what was considered a loss sustained by it through the sale of the season's production of crude cottonseed oil at unsatisfactory prices. The transactions had none of the characteristics of a protection against loss due to fluctuation in the market of a

product which petitioner had sold for future delivery. It had used the cottonseed which it had purchased at a fixed price and had likewise sold the crude oil at a fixed price when it entered into the contracts to purchase refined oil futures. The transactions in futures have all the earmarks of purchasing and selling for future delivery with a view to profit based on the law of supply and demand or some other economic changes in the industry which would affect prices. United States v. New York Coffee & Sugar Exchange, 263 U. S. 611, 44 S. Ct. 225, 68 L. Ed. 475.

Section 112(a)(b) of the Internal Revenue Code, 26 U. S. C. A. Int. Rev. Code, § 112(a)(b), provides in substance that the entire amount of gain or loss determined under Section 111 of the Code shall be recognized except that neither gain nor loss shall be recognized if property held for productive use in trade or business or for investment is exchanged solely for property of like kind and held for the same purpose. There is excluded from the exception stock in trade or other property held primarily for sale, stocks, bonds notes, choses in action, certificates of trust or beneficial interest or other securities or evidence of indebtedness or interest.

Petitioner contends that when it sold a refined oil futures contract and purchased another for the same quantity of oil for the purpose of maintaining its position in the futures market without the necessity of taking delivery of any oil, the sale was not a closed transaction, but that taxable gain or deductible loss on the sale resulted only when it sold a contract and did not simultaneously purchase another contract for future delivery of a like amount of refined oil.

[3-5] The transactions of petitioner in oil futures are clearly within Section 112(a) unless they come within the proviso of Section 112(b) and are not within its exclusions. It is well settled that the language of the Revenue Act is to be taken in its ordinary meaning unless the context or legislative history of the enactment impels a different

interpretation. Old Colony Railroad Company v. Commissioner, 284 U. S. 552, 560, 52 S. Ct. 211, 76 L. Ed. 484. The Congress must be presumed to use words in their ordinarily known signification. Levy's Lessee v. McCartee, 6 Pet. 102, 31 U. S. 102, 110, 8 L. Ed. 334. The popular or usual import of words furnishes the general rule for the interpretation of public laws. Maillard v. Lawrence, 16 How. 251, 57 U. S. 251, 261, 14 L. Ed. 925.

[6] The purpose of Section 112(b) was to save the taxpayer from an immediate recognition of gain and the tax thereon and conversely to intermit the claim of a loss in exchange transactions where gain or loss may have occurred in a constitutional sense, but where in a popular and economic sense there had been a mere change in the form of ownership or in other words that substance and not form should control in determining whether gain or loss had been realized or sustained. Portland Oil Company v. Com'r, 1 Cir., 109 F. 2d 479.

[7] The context of the Revenue Act and its legislative history give no hint that the word "exchange" as used in Section 112(b) is to be given other than its ordinary meaning. In this sense it means a mutual grant of equal interests, the one in consideration of the other. "Exchange" is a word of precise import, meaning the giving of one thing for another, requiring the transfers to be in kind, and excluding transactions into which money enters either as the consideration or as a basis of measure. United States v. Rodenbough, D. C. Pa., 21 F. 2d 781. The term is almost synonymous with "barter." Postal Tel. Cable Co. v. Tonopah & T. R. R. Co., 248 U. S. 471, 474, 39 S. Ct. 162, 63 L. Ed. 365.

[8, 9] The sale of property and the immediate repurchase of like property is not an exchange, because the basis of the transaction is measured in money. This rule clearly appears where parties, through a common broker, sell property to one person and purchase similar property

from another. The transaction has none of the characteristics of an exchange but consists of two sales. Petitioner's transactions in futures were sales and profit or loss resulted from each transaction depending upon whether petitioner received more or less than the original cost of the futures sold. The purchases of other futures simultaneously with each sale did not result in an exchange.

Section 118(a) of the Internal Revenue Code, 26 U. S. C. A. Int. Rev. Code, § 118(a), provides in substance that no loss shall be allowed from any sale or other disposition of shares of stock or securities where it appears that within a period beginning thirty days before the date of such sale or other disposition and ending thirty days after such date, the taxpayer has acquired or has entered into a contract or option so to acquire substantially identical stock or securities.

Petitioner insists that the repurchase by it of futures contracts simultaneously with the sale of such contracts is controlled by the above section of the Code, and that the new purchases by it within thirty days after the sale took the cost of the old futures sold, and that the losses claimed by it on its original return for the fiscal year ending August 31, 1939, should be disallowed in that year and allowed the following year.

The statute does not define the term "stock or securities", and it is therefore necessary to resort in interpreting the provision to the common and ordinary meaning of these words. The earlier Revenue Acts permitted broadly the deduction of losses on the sale of securities. Under these acts, where a taxpayer made a bona fide sale of securities, although he purchased simultaneously the same securities at the same price, the loss was allowable. The Congress, realizing that loss of revenue was inherent in these transactions, in the 1921 Revenue Act erected the present barrier to their deduction.

The sole purpose of the statute was to prevent the deduction of losses from net income and the Congress set up as a barrier a more or less arbitrary standard to overcome the evil. Unless losses from dealings in commodity futures through a broker are within the statute, the barrier is weakened, because the dealings in such property on exchanges of the country is almost as extensive as that in stocks and bonds.

The whole question turns on the meaning of the word "securities." It may be helpful in arriving at a correct definition to give some thought to the character of the transactions with which we are dealing.

[10] The relationship between petitioner and the broker was that of pledgor and pledgee. Richardson v. Shaw, 209 U. S. 365, 376, 28 S. Ct. 512, 52 L. Ed. 835, 14 Ann. Cas. 981. An assignment of a contract for delivery of refined cottonseed oil on a future day as collateral operates in equity as a contract for a pledge, and the lien attaches to the oil as soon as it comes into existence and possession under the contract. The contracts petitioner made with its broker, although executory at the beginning, were made for the express purpose of being transferred directly or indirectly by further contracts. They constituted evidence of a right to property and they could be assigned and transferred and were security to the broker who had advanced the necessary funds to purchase the oil. The broker held the oil in trust to the extent of its claim and then for the petitioner.

Webster's International Dictionary defines "securities" as "that which secures or makes safe; Specifically, something given, deposited or pledged; to make secure or certain; or certain the fulfillment of an obligation; the payment of a debt; an evidence of debt or of property, as a bond, a stock certificate or other instrument, etc.; a document giving the holder the right to demand and receive property not in his possession." The Oxford English

Dictionary says a "security" is a "document held by a creditor as guarantee of his right to payment; hence, any particular kind of stock, shares or other form of investment guaranteed by such documents." As applied to dealings in property and to commercial transactions, the word "security" under present usage has a generous scope far beyond its literal meaning.

It may be that when petitioner sold futures contracts and repurchased others of a like amount there was a constructive delivery of the cottonseed oil to petitioner and a constructive re-delivery to the broker, but considering the substance of the transactions rather than their form, petitioner had no more than a document giving it the right to demand and receive property not in its possession. This is a security.

[11] We think it is quite clear that petitioner was using the facilities of the Commodity Exchange in its business of buying and selling rights in commodities and that it is equally clear that the Tax Court was correct in holding that the losses petitioner sustained were capital losses subject to limitations of Section 117(d). On the other hand, we think it is just as clear that in those instances where petitioner sold a futures contract and bought a new futures contract for the same quantity of cottonseed oil sold, a wash sale of securities under Section 118 resulted.

In determining taxable income of petitioner for the years in question, the losses or gains sustained or realized by it in the sale and purchases of cottonseed oil futures should be determined under Sections 117 and 118 of the Internal Revenue Code integrated.

The order of the Tax Court is reversed and the cause is remanded for further proceedings consonant with this opinion.

Appendix C

TRENTON COTTON OIL COMPANY, PETITIONER v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 110950. Entered December 28, 1943.

Robert P. Adams, Esq., and Taylor E. Cress, C. P. A., for the petitioner.

Charles P. Bagley, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

MELLOTT, *Judge*:

The Commissioner determined the following deficiencies in tax:

Fiscal Year Ending	Income Tax	Excess Profits Tax
August 31, 1939	$1,773.07	.....
August 31, 1940	9,780.50	$5,163.92

Some of the adjustments are not contested. One issue raised by the pleadings involves an expenditure of $65.40 which the respondent determined was a capital expenditure. No evidence was adduced upon this issue. All other charges of error arise from the respondent's treatment of petitioner's dealings in futures for cottonseed oil.

Summarizing the charges of error petitioner contends that the respondent erred: (a) in determining that its losses from such dealings in futures were not losses from "hedging" but were capital losses; (b) in determining that each transaction on the Commodity Exchange resulted in taxable gain or loss; and (c) in determining that such losses were not losses from "Wash Sales". (Section 118, Revenue Act of 1938).

Appendix C

FINDINGS OF FACT

Petitioner is a Tennessee corporation located at Trenton, Tennessee. Its books are kept and its returns are made on a fiscal year basis beginning September 1 and ending August 31. Its returns for the taxable years were filed with the collector of internal revenue for the district of Tennessee.

In the taxable years and for many years prior thereto petitioner was engaged in the business of operating a cottonseed oil mill for the production of crude cottonseed oil and by-products, consisting principally of cottonseed meal, cottonseed hulls and linters. The business of crushing cottonseed oil is seasonable, beginning about the middle of September and continuing for six or seven months.

During the taxable years petitioner had two cottonseed storehouses having a capacity of between 9,000 and 10,000 tons. It purchases and crushes approximately 11,000 tons of cottonseed a year. During the crushing season it always has a substantial quantity of cottonseed on hand.

Crude cottonseed oil deteriorates rapidly, especially in warm weather, and has to be refined shortly after it is produced. Petitioner had no facilities for refining crude oil and its storage capacity for crude oil was quite limited, being only approximately 4½ tanks, equivalent to approximately 2 weeks' production. It is impractical either to store the crude cottonseed oil, or, in a small mill like petitioner's, to have it refined.

Petitioner's purchases of cottonseed are not all made at one time. Most of its seed is purchased from ginners in quantities of approximately 100 tons at a time. The cottonseed is bought on grade at a "basis" price which is subject to adjustment when the seed is analyzed and graded upon delivery. Petitioner also, in advance of

the cotton season, frequently makes loans to ginners in order to get their cottonseed. When such loans are made it is understood that the ginners will offer their seed to petitioner at market before disposing of it elsewhere; but petitioner is not thereby committed to purchase any quantity of such seed.

As petitioner purchases cottonseed, it determines the quantity and grade of crude oil which will be produced therefrom and usually sells the oil for delivery as produced at a fixed price.

In the season 1938-1939 petitioner produced 67 tanks of crude cottonseed oil. At the beginning of the season the price was unsatisfactory and was recognized by petitioner and its officers and stockholders to be unsatisfactory. The situation was discussed by petitioner's officers and its 7 stockholders and decision was reached to purchase on margin on the Commodity Exchange substantially an equal number of tanks of refined oil for future delivery. It was agreed that petitioner would maintain its "long" position in refined cottonseed oil until such time as the prices for its crude cottonseed oil became satisfactory. There is no futures market for cottonseed or for crude cottonseed oil.

Under the rules of the Commodity Exchange futures contracts for refined cottonseed oil are limited to 7 months. The only way petitioner could maintain its "long" position over a period of time greater than 7 months was to dispose of its contracts prior to the delivery date and acquire other contracts calling for the future delivery of a like amount of refined oil in a later month. This was accomplished by means of "switching" through the brokers.

A "switching" requires that the brokers either find somebody who is willing to take, for example, 10 tanks of May delivery in exchange for 10 tanks of September delivery or that the 10 tanks, the date for delivery of

which is approaching, be sold on the market and 10 tanks for delivery at a later date be purchased. Such transactions are always treated by the brokers as a purchase and sale, are so shown on the broker's statement to the customer and a commission is charged by the broker.

A tank of crude cottonseed oil consists of approximately 60,000 pounds. As sales were made during the 1938-1939 season by petitioner of its crude cottonseed oil an equivalent amount of refined cottonseed oil was bought on the Commodities Exchange for future delivery. This was done in connection with all except the last 9 tanks of crude cottonseed oil produced and sold by petitioner. The sales and purchases were as follows:

Date Crude Oil Shipped	Tanks	Date Futures Refined Oil Bought	Tanks	Maturity of Futures Contracts
10/ 3/38	10	10/ 3/38	10	May
10/19/38	5	10/19/38	5	May
10/28/38	5	10/28/38	5	May
10/31/38	5	10/31/38	5	May
11/ 2/38	5	11/ 2/38	5	May
12/29/38	7	12/29/38	7	July
1/23/39	5	1/23/39	5	July
2/ 6/39	5	2/ 6/39	5	Sept.
2/23/39	5	2/23/39	5	Sept.
2/27/39	6	2/27/39	6	Sept.
Total	58 Tanks		58 Tanks	

As the maturity dates of the futures contracts approached petitioner requested its broker to "switch" such contracts to contracts maturing at a later date. The details of these transactions are not shown in the present record. Petitioner was required to maintain a margin of $300 per tank on its purchases of refined oil and, as the price declined, it was required to make additional

deposits. The gain or loss on each sale was reflected in petitioner's account on the books of the broker; but neither the books nor copies thereof are in evidence.

In dealing in futures on the Commodity Exchange when a futures contract is sold by the broker the proceeds are credited to the account of the customer and any credit then shown in the account may be withdrawn by the customer. If contracts for delivery at a later date are purchased, they may be paid for at that time or they may be carried on margin. Final settlement is made when the contracts are sold or fulfilled.

In September of 1939 (during the fiscal year ending August 31, 1940) petitioner sold the 58 tanks of refined oil which it had purchased for future delivery and thereafter made no further purchases of futures.

The losses sustained by petitioner in connection with the "switching" of its position during the fiscal period beginning September 1, 1938 and ending August 31, 1939 amounted to $62,400. On its income tax return for that period petitioner deducted $62,400, reporting on its income tax return for that period a net loss of $48,062.85. In determining the deficiency in tax for that period the respondent determined that the losses resulted from the sale of capital assets and were allowable only to the extent of $2,000 under Section 117 (d) of the Revenue Act of 1938.

The contracts acquired by the petitioner through the "switching" operations in the earlier fiscal year, owned by it at the beginning of the latter fiscal year, and sold by it during that period, resulted in a profit to petitioner of $47,514.

In its return for the fiscal year ending August 31, 1940 petitioner reported net income of $7,525.66. In preparing its return for this period petitioner offset against the profit realized from its dealings in futures during that

period—$47,514—the loss which had been sustained in the earlier period—$62,400—and deducted from gross income the difference between these amounts, i. e., $14,886 as a loss. The deduction was disallowed by the respondent, the $47,514 was included in gross income and other adjustments were made which are not now in issue.

Opinion

As indicated at the outset petitioner contends that its purchases and sales of refined cottonseed oil were "hedges". The essence of its argument upon brief may be gleaned from the following excerpt:

> * * * On account of the unsatisfactory market conditions of seed and crude oil prices, petitioner sold its crude oil, when the seed that produced it was bought, and the crude oil was actually delivered, as sold. Having seed on hand to be processed and being committed to accept future seed at an undetermined price, every time petitioner sold its crude oil, it did not place orders for future purchases of refined oil, but it actually bought, at the same time of its sale, a specified number of tanks of futures refined oil at a then and there designated price, to protect and insure itself against an equal number of tanks of crude oil to be later manufactured; and at no time did petitioner sell crude oil and then, at a later date, purchase futures contracts of refined oil. When it sold 10 tanks of crude oil at a definite fixed price knowing that it would manufacture, from seed on hand and seed for which it was committed, another 10 tanks of crude oil, which it had to sell, petitioner, then and there, bought at a fixed, definite price 10 tanks of futures refined oil.

Paradoxically both parties rely upon Commissioner v. Farmers & Ginners Cotton Oil Co., (CCA 5) 120 F.

(2d) 772, certiorari denied 314 U. S. 683. This case originated before the Board of Tax Appeals, which, after promulgating a decision sustaining the Commissioner's view that futures contracts were capital assets and the losses resulting therefrom were deductible only to the extent allowed by the capital gain and loss provisions of the statute (Farmers & Ginners Cotton Oil Co., 41 BTA 255), reversed the holding of the Division (idem 41 BTA 1083) several members dissenting, and held that the dealing in futures was a "hedge." The Circuit Court of Appeals reversed. Petitioner attempts to support its theory—which seems to be that the "hedge" was against cotton seed rather than against crude cottonseed oil—by quoting several excerpts from the opinion of the court. Thus it says the facts are entirely different because it had not followed what the court referred to as "the customary practice" of the taxpayer in the cited case, "to sell the crude oil at the prevailing market price and then to place orders [sometimes weeks later] with brokers to purchase futures * * *." Also "it [Farmers & Ginners Co.] sold crude and bought refined when it had no actual commodity on hand or future commitments to be protected from price variations. * * * It had no crude or refined oil on hand when it bought or sold the futures from which the losses in controversy were incurred." These quotations, petitioner insists, "seem to say that if the Farmers & Ginners Cotton Oil Company had actual commodity on hand and had actual commitments to be protected against, that it would amount to a true 'hedge'." We do not agree.

A hedge, as the court pointed out, "is a form of price insurance; it is resorted to by business men to avoid the risk of changes in the market price of a commodity. The basic principle of hedging is the maintenance of an even or balanced market position." It is "a means by which collectors and exporters of grain or other products, and manufacturers who make contracts in advance for the

sale of their goods, secure themselves against the fluctuations of the market by counter contracts for the purchase or sale, as the case may be, of an equal quantity of the product, or of the material of manufacture." Board of Trade v. Christie Grain & Stock Co., 198 U. S. 236, 249. "To exercise a choice of risks, to sell one commodity and buy another, is not a hedge; it is merely continuing the risk in a different form." Commissioner v. Farmers & Ginners Cotton Oil Co., supra. While we are of the opinion that is what petitioner did, we will analyze its contention more fully in the light of the evidence adduced.

Petitioner upon brief refers to its "commitments" for cotton seed. While it is clear it had to have cotton seed if it expected to carry on its crushing business, it is far from clear that it ever had any real "commitments" for the purchase of seed other than its contracts with ginners for the purchase, at market, of 100 ton lots. "The basis price would be fixed on that 100 tons. When he delivered that possibly he would sell some more." Nor can any real "commitments" be spelled out of the loans made by petitioner to the ginners. Petitioner merely agreed to loan them money if they would bring their seed to it; but it "had no agreement as to what price it would pay" when the money was loaned. "No agreement as to price; it would be at the market at the time they delivered the seed." Nor is there any evidence from which it could be determined that petitioner always had on hand, at the time each future was purchased, sufficient seed to manufacture an equal quantity of crude oil. However that may be, it is clear petitioner decided to purchase futures, not because of the price of cotton seed or its commitments to purchase cotton seed but because of the "unsatisfactory crude oil prices." When its responsible officer, testifying as a witness, was asked whether the purpose of the company in purchasing the futures was to protect it against what it had sold or had to sell (crude oil) or to protect the seed it had contracted to

buy; he said "Both." As we view it, the distinction, if any, between the present facts and those before the court in the Farmers & Ginners case is so small as to be practically negligible.

In our judgment petitioner has failed to prove that its dealing in futures was a true "hedge". On the authority of Farmers & Ginners Cotton Oil Co., supra, decision must be entered limiting its loss in the fiscal period ending August 31, 1939, to $2,000 unless a different result is justified under some theory not yet considered.

Petitioner contends that taxable gain or deductible loss from its transactions resulted only when, upon closing out a contract for the future delivery of refined cottonseed oil, it did not simultaneously acquire another similar contract. It also contends that the losses from its "switching" are not recognizable because of the "Wash Sales" provisions of the statute.[1]

Transactions in commodity futures are commonly referred to either as a purchase and sale of specific commodities, or a purchase and sale of contracts under which the trader acquires a right to the specific commodity. In either view there is a purchase and sale of property. George W. Covington, et al., 42 BTA 601, affirmed on this point Commissioner v. Covington, 120 F. (2d) 768, certiorari denied 315 U. S. 822. The petitioner, having purchased futures, could demand delivery of the com-

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[1] SEC. 118. LOSS FROM WASH SALES OF STOCK OR SECURITIES.

(a) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 23 (e) (2); nor shall such deduction be allowed under section 23 (f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business.

modity or sell its right to the commodity to another. It therefore makes no difference whether the transaction was closed by an exchange of warehouse receipts or without that formality. In legal effect there was a delivery of the commodity sold Board of Trade v. Christie Grain & Stock Co., supra; Lyons Milling Co. v. Goffe & Carkener, Inc., 46 F. (2d) 241. It must be assumed that the gain or loss incident to the sale and all charges, including the broker's commissions, were reflected in petitioner's account on the books of the broker and on the statement which it sent to the petitioner. While the statements are not in evidence the broker testified, and we take judicial notice of the fact, that at any time a sale was made petitioner could have drawn down any resulting profit. Its losses, if any, likewise then became payable after the margin was exhausted. It is therefore plain that the transaction was closed for income tax purposes and the losses occasioned thereby were incurred in the sale or exchange of a capital asset within the meaning of section 117 of the Revenue Act of 1938. Nor was the character of the transaction changed by the fact that the petitioner, at the time of the sale of refined oil futures, concurrently purchased an equal amount of the same commodity for future delivery. Robert M. Harriss, 44 BTA 999 (on appeal 2 CCA); Valley Waste Mills v. Page, 115 F. (2d) 466, certiorari denied 312 U. S. 681.

Petitioner's contention that its transactions in refined oil futures come within the "Wash Sales" provision of the statute must also be denied. The statute relates only to stock or securities. Here, as has been pointed out, petitioner sold and purchased refined cottonseed oil or a right to such oil, which for present purposes amounts to the same thing. When a sale was made the transaction was closed and taxable gain or deductible loss resulted. Valley Waste Mills v. Page, supra.

The Commissioner committed no error in determining the deficiencies in tax.

Decision will be entered for the respondent.

WHITNEY v. COMMISSIONER OF INTERNAL REVENUE

No. 5323

Circuit Court of Appeals, Third Circuit.

October 3, 1934.

Petition for Review from the United States Board of Tax Appeals.

Petition by Richard Whitney to review an order of the Board of Tax Appeals redetermining a deficiency in the tax imposed by the Commissioner of Internal Revenue.

Order of redetermination modified in accordance with opinion.

Frederic E. Mygatt, Jr., of New York City, for petitioner.

Frank J. Wideman, Asst. Atty. Gen., and Sewall Key and Carlton Fox, Sp. Assts. to Atty. Gen., for respondent.

Before DAVIS, Circuit Judge, and CLARK and JOHNSON, District Judges.

DAVIS, Circuit Judge.

This petition for review involves a deficiency in income taxes for the year 1927. The questions here are whether or not the petitioner may deduct from his gross income

certain dues and contributions paid, as a member, to the New York Stock Exchange and losses sustained in operating a racing stable.

During 1927, the petitioner was a partner in the brokerage firm of Richard Whitney & Co. He and two other partners were members of the New York Stock Exchange. The rules of the Exchange required individuals to own seats, but permitted an individual to assign his seat to his firm for its use. This was done by the petitioner and his partners and, under the partnership agreement, the firm paid all the dues and assessments on the seats owned by the firm members.

In 1927, Richard Whitney & Co. paid a total of $1,981.86 to the Exchange on behalf of the three seats held by its members. Of this amount $1,019.83 was the proportion charged to the petitioner by the partnership under the agreement that all charges of the Exchange on members' seats should be paid by the partnership. It should be noted that this sum charged to the petitioner does not represent the dues and assessments on the seat owned by him, but the share chargeable to him in proportion to his interest in the firm. That is so for the reason that members of partnerships are assessed for income tax on their distributive shares of the net income of the partnership. Section 218, Revenue Act 1926 (26 USCA § 959).

From the record it appears that the Stock Exchange charged the petitioner a total of $970 for his seat in 1927. That amount represents $800 for dues and $170 for contributions to the Gratuity Fund of the Exchange.

The constitution of the Stock Exchange requires each member to pay dues, not to exceed $1,000 annually, to be used for current expenses or capital investment as determined by the Governing Committee of the Exchange or to be subject to suspension or expulsion. The record shows

that the books of the Exchange treated the dues paid by the petitioner as capital contributions.

The constitution of the Exchange provides that each member shall contribute $10 to the family of a deceased member. That is called the Gratuity Fund. During 1927, the petitioner was required to make payments of $170 to the fund, but his bills from the Exchange showed a credit in the fund of $79.67 for some reason not appearing, and he therefore made net payments on this account of only $90.33.

The Commissioner and the Board of Tax Appeals held the petitioner accountable in his return for the sum of $1,019.83. The record is not entirely clear, but so far as we understand it, the petitioner's seat was assessed $800 for dues and $170 for contributions to the Gratuity Fund.

The petitioner contends that he is entitled to a deduction of $1,019.83 for ordinary and necessary expenses paid during the taxable year in carrying on his trade or business as a broker, "including * * * rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title." Section 214(a)(1), Revenue Act 1926, 26 USCA § 955(a)(1).

[1] The sum of $1,019.83, which the petitioner claims as a deduction, represents the proportion chargeable to him of the payments made in 1927 by the partnership for the seats assigned to it by the partners. The petitioner, himself, was obligated to the Exchange in 1927 for his own seat for a total of $970, of which $800 was allocated to his seat and $170 to the Gratuity Fund. The difference between the sum charged to him by the partnership and the total of his obligations to the Exchange is $49.83. He is entitled to deduct this difference from his

gross income as an ordinary and necessary expense of carrying on business for 1927.

But the charges against his membership of $970 stand in a different light. The membership was not partnership property. It belonged to the petitioner and was merely used by the partnership.

The petitioner contends that it is immaterial as to what the Stock Exchange does with the dues under section 214(a)(1), which provides that:

"Sec. 214. (a) In computing net income there shall be allowed as deductions:

"(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. * * *"

He says that the government has erroneously read a qualification into this section to the effect that expenses required to be paid as a condition to the continued use of property are not deductible *if the recipient makes a gift or invests any of the payments.*

It is true that the statute is concerned only with the nature of the payments made by the taxpayer and not how the person who receives the payment may choose to use it. The question here is whether or not the several items which total the sum of $970, charged to the petitioner, were ordinary and necessary expenses incurred in carrying on business.

[2] Obviously, the owner of a seat on the Stock Exchange must pay dues and charges. The payments are necessary. But that is not enough. A capital investment may be necessary in carrying on a business. Section 215 (26 USCA § 956) provides that no deductions shall be allowed for "any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate." The expense

of business must also be ordinary. That is, it must be a usual or customary expenditure in the course of business during the year. Duffy v. Central Railroad Co. of New Jersey, 268 U. S. 55, 45 S. Ct. 429, 69 L. Ed. 846; Welch v. Helvering, 290 U. S. 111, 54 S. Ct. 8, 78 L. Ed. 212.

[3] The New York Stock Exchange is an association. When the petitioner purchased his seat on the Exchange he made a capital investment. He acquired an interest in the assets of the Exchange as well as the right of trading. The record shows that the dues paid by members were treated in 1927 as capital improvements squarely within the meaning of section 215, which prohibits deductions in such cases.

[4] But in the case of the payments to the Gratuity Fund, a different situation confronts the court. These payments by reason of the petitioner's membership in the Exchange amounted to $170 for 1927. The record shows items amounting to $79.67 were credited against the total of $170, but the petitioner has failed to show the reason for this credit. The balance of $91.33 may be deducted as an expense of carrying on business. These payments were for the benefit of the families of deceased members of the Stock Exchange and were required by its constitution.

The petitioner also contends that he is entitled to a deduction for 1927 from his gross income of $10,326.40 incurred in operating a racing stable.

The issue here is a question of fact: Whether or not the racing stable was operated as a business, or a transaction entered into for profit, though not connected with a trade or business. The Board determined that the losses incurred in operating the stables were personal expenses and that the petitioner's primary motive in carrying on the stables was for the pleasure gained from a hobby.

The petitioner has operated a racing stable since 1918.

There is no information as to the amount of his investment, but his operating expenses generally appear to have increased each year. The evidence shows clearly that the stable was run on a business basis. The petitioner kept books, records, and accounts. He employed trainers, jockeys, and other necessary assistants, and he, himself, supervised and directed the stable, actively and continuously. He has used various methods and experimented considerably to improve his stable. The petitioner has maintained the stable apart, and as a separate business, from his several other enterprises. It is true that the expenses of the stable have exceeded the revenue which is principally derived from prizes, stakes, and the proceeds from sales of horses; but the petitioner testified that he intended and hoped to derive profits from the operation of the stable.

[5, 6] There is no question that a number of racing stables are made as much of a business as the operation of a mercantile establishment and profits are realized thereby. There could be merit in the government's argument, if the facts warranted the conclusion, that racing is the sport of the wealthy, and that the maintenance of a stable is not a business expense but a personal expense. The question is not a philosophical one, but a practical one and involves the determination of whether the petitioner's stable was operated as a business or for pleasure. The Board and this court, in reviewing the order of redetermination, are confined to the facts set out in the record. The burden of proof was on the petitioner before the Board, and if he met it, the burden shifted and the government was required to come forward with evidence to refute the evidence of the petitioner. It did not do so and the Board cannot draw inferences and conclusions from facts or suppositions outside of the record.

The decision of the Board that the petitioner was not

conducting a business was based on the facts that he had not claimed deductions for the losses prior to 1927; that the operation of the stable has not shown a profit from 1918, the year in which it was established; and the assertion that the pleasure in owning a stable was the primary interest of the petitioner.

[7] That the petitioner did not claim a deduction for losses prior to 1927 and that the stable was unprofitable for the eight years it had existed will not support the decision of the Board under the evidence in this case. There is no substantial evidence to support the conclusion that the pleasure of owning the stable was the primary interest of the petitioner in operating it. The evidence in this case is so similar to that in the case of Commissioner v. Widener, 33 F. (2d) 833 (C. C. A. 3); that it is controlling here.

The order of redetermination is modified in accordance with this opinion.

STIMSON MILL CO. v. COMMISSIONER OF INTERNAL REVENUE.

No. 11548.

Circuit Court of Appeals, Ninth Circuit.

July 21, 1947.

Upon petition to review a decision of the Tax Court of the United States.

Petition by the Stimson Mill Company to review a decision of the Tax Court, 7 T. C. 1065, redetermining a deficiency in an excess profits tax imposed by the Commissioner of Internal Revenue.

Decision affirmed.

Bert L. Klooster, of Chicago, Ill., (Chapman & Cutler, of Chicago, Ill., of counsel), for petitioner.

Sewall Key, Acting Asst. Atty. Gen., Helen R. Carloss and Carlton Fox, Special Assts. to Atty. Gen., for respondent.

Before STEPHENS, HEALY and ORR, Circuit Judges.

ORR, Circuit Judge.

The question presented by this petition, is whether §713(e)(1) and §722 of the Internal Revenue Code, 26 U. S. C. A. Int. Rev. Code, §§713(e)(1), 722, in force in 1942, may both be used to determine the excess profits credit of a taxpayer for the year 1942, or whether the two sections are mutually exclusive.

We will refer herein to petitioner as taxpayer, and to respondent as the Government. The facts and the statutory provisions are both lengthy and complex. We therefore set them forth in some detail.

The statutory scheme of the now-repealed excess profits tax was to separate corporate profits earned during the war years into two classes, normal and excess, and to tax each class of profits at different rates.

Under the 1942 law, applicable here, a corporate taxpayer first determined its ordinary net income, or "normal tax income", and then, by additions and subtractions to that figure, not material here, determined its "excess profits net income". From this last item, certain deductions are made, the most important of which is the "excess profits credit". This credit represents the statutory standard of normal earnings. Once this "excess profits credit" is determined it represents the profits (for 1942 in this case) which are subject to the normal tax, imposed at the rate of 40% of such profits. All of taxpayer's earnings

above the "excess profits credit" (with exceptions not material here) are subject to the excess profits tax imposed at the rate of 90% of such profits.[1]

In the computation of a taxpayer's "excess profits credit" we have at least one instance in tax law where a taxpayer desires to have his normal profits as high as possible. For the higher the normal profits the greater the amount of taxpayer's earnings that will be taxed at the 40% rate rather than the 90% rate.

All but a small fraction of the "excess profits credit" is made up in this case by first taking taxpayer's actual earnings for the four years 1936 to 1939, inclusive. § 713(b), I. R. C.

For those four years taxpayer earned the following amounts:

1936	$ 89,422.67
1937	63,706.57
1938	38,127.75
1939	111,839.77
Total,	$303,096.76

Under § 713(e)(1), the earnings in the lowest year (1938) are automatically raised by the "75% rule" to an amount equal to 75% of the average earnings of the other three years. This sum, ($66,242.25 in this case) is required to be substituted for the actual 1938 earnings. Considering this new figure for 1938, taxpayer's total for the four year base period is increased to $331,211.26, and the "average base period net income" is thus $82,802.82. And when we take 95% of this "average base period

[1] Cf. §§ 710, 711, 713, I. R. C., 26 U. S. C. A. Int. Rev. Code, §§ 710, 711, 713. Mertens Law of Fed. Inc. Taxation, § 42.01-3; See footnote 3.

net income", or the sum of $78,662.68, we have computed the excess profits credit. § 713(a)(1)(A).[2]

Therefore, in the absence of any further facts, $78,662.68 of taxpayer's 1942 earnings would be subject to the normal tax and all of its earnings over that amount would be taxed as excess profits at the rate of 90%.[3]

In the instant case additional facts are present. Taxpayer claims relief under § 722 and in pursuance of that claim it is stipulated that taxpayer has established that its normal output was interrupted in 1937 by strikes "* * * events peculiar in its experience, as provided by § 722(b)(1), I. R. C.". The Government has further stipulated that taxpayer has established that its actual 1937 earnings ($63,706.57) were abnormally low, and that "the fair and just amount representing normal earnings which would be used by [taxpayer] as its constructive average base period net income under the provisions of § 722 (exclusive of § 713), for the year 1942 would be determined after reconstructing earnings for the year 1937 * * * from the actual amount * * * to the reconstructed amount of $85,263.34."

Section 722 provides that when a taxpayer establishes (as taxpayer here has done by stipulation) that "the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income * * * *the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter.*" (Italics ours.)

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[2] We shall designate this method of computing taxpayer's excess profits credit as the Government's method.

[3] We have simplified the foregoing discussion of the excess profits tax by eliminating other complicating features of the tax not relevant here.

It is also stipulated that taxpayer is not entitled to any other constructive adjustments to actual earnings under § 722 in the other three base period years.

Under § 722 taxpayer's earnings for the base period considering the reconstructed figure for 1937 would be:

1936	$ 89,422.67	
1937	85,263.34	(reconstructed earnings under § 722)
1938	38,127.75	
1939	111,839.77	
Total	$324,653.53	
Constructive average base period net income:	$ 81,163.38	
95% of above sum (excess profits credit)	$ 77,105.22	

By this method of computing the excess profits credit (and to which method we shall refer as Method 2) where § 722 alone is used without raising the 1938 earnings by the 75% rule of § 713(e)(1), taxpayer receives a lower excess profits credit than if the Government's method is adopted. Notwithstanding the fact that taxpayer has established its right to constructive earnings of $85,263.34 for 1937 under § 722, and its right to use a "constructive average base period net income *in lieu* of the average base period net income", the Government has allowed use of the "average base period net income" under § 713(e)(1), and the latter, or Government's, method of computing the excess profits credit is to taxpayer's advantage.

Thus far there is little dispute. Neither side desires to use Method 2. The crux of this case, however, lies in taxpayer's contention that it is entitled to use *both* § 722

to raise its 1937 earnings, *and* § 713(e)(1) to raise its 1938 figures. By this third, or taxpayer's method, as we shall hereafter refer to it, taxpayer's earnings for the base period years would be:

1936	$ 89,422.67	
1937	85,263.34	(reconstructed under § 722)
1938	71,631.44	(raised under 75% rule of § 713(e)(1))
1939	111,839.53	
Total	$358,157.22	

The average of this total is $89,539.31, and 95% of that sum, or the excess profits credit, is $85,062.35, rather than the $78,662.68 allowed by the Government's method.

It is apparent that taxpayer's method requires *first*, the use of § 722 to raise the 1937 figures, and, *second*, the use of § 713(c)(1) to raise the 1938 figures, since one of the three years used to obtain the new 1938 figure is the reconstructed (not the actual) figure for 1937 obtained by the use of § 722.

The solution of this case resolves itself into a problem of statutory construction, the key to which lies in determining whether, in computing the "constructive average base period net income" under § 722, the 75% rule of the "average base period net income" of § 713(e)(1) may also be used, or whether the two are mutually exclusive.

The Government determined a deficiency of $2,106.08 in taxpayer's excess profits tax liability for the year 1942 as a result of denying taxpayer's claimed relief under § 722. Resort was had to the Tax Court. In sustaining the Government's contention that court placed its decision on two grounds: First, that § 713(e)(1) does not permit

the use of earnings constructed under § 722 for any of the three years of the base period used in raising the lowest year; and, second, that § 722 provides that the "constructive average base period net income", computed under that section shall be used "in lieu of" the "average base period net income", computed under § 713(e)(1).

The Tax Court concluded that petitioner had failed to establish that relief afforded by the use of § 713(e)(1) alone, and allowed by the Government, was less than a "fair and just amount representing normal earnings * * *" and therefore held that the Government had correctly determined taxpayer's excess profits tax liability for 1942.[4]

[1] At the outset of our consideration of this case we are met by the Government's argument that § 732(c) deprives us of jurisdiction to review the determination of the Tax Court.

Section 732(c) provides:

"If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711(b)(1) (H), (I), (J) or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the [Tax Court]."

In James F. Waters Inc., v. C. I. R., 160 F. 2d 596, we held that § 732(c) is valid, and that Congress may preclude judicial review of the determinations of the Tax Court in respect to statutes such as § 722 which create special relief provisions "reminiscent of sovereign gracious clemency" Pohatcong Hosiery Mills, Inc., v. C. I. R., 3 Cir., 162 F. 2d 146, 149. We think the determination of the question before the Tax Court involved both § 722 and § 713(e)(1).

[4] See also The Homer Laughlin China Co., 7 T. C. 1325, where the same result was reached on virtually identical facts.

It is of course possible to cast the problem, as the Government has done, solely in terms of § 722 by stating that taxpayer was allowed the benefits of § 713(e)(1) and that the only question is whether he is entitled to § 722 relief. But the nature of the § 722 relief sought by taxpayer should not be overlooked. Taxpayer concededly has established, under § 722, that its earnings for the year 1937 should be raised. Averaging said constructive 1937 earnings with taxpayer's actual earnings for the other three years of the base period (since taxpayer is not entitled to raise constructively its earnings for those other three years) would result in its excess profits credit being less than if its 1938 earnings are raised under § 713(e)(1) and its 1937 earnings are left unaffected by § 722.

Taxpayer asks to raise both 1937 and 1938 earnings by the use of both sections. It was this double relief that the Government refused to allow, and the determination of that question clearly was necessary by reason of both sections. For were it not for § 713(e)(1) taxpayer could have no question as to his tax liability to be determined.

By stipulation he established the right to raise the 1937 figures under § 722, and by stipulation he was not entitled to raise other years under that section. The determination of his tax liability can be resolved only by the determination of a question arising under both sections, namely, whether taxpayer may raise his 1938 earnings under § 713 (e)(1) by using the constructive earnings of one year computed under § 722.

The Government concedes that "there is here involved only the question whether the § 722 construction should reflect the § 713(e)(1) adjustment."

It is true that § 722(d) requires a taxpayer to compute his tax without applying § 722, but while this may be an argument in favor of the Tax Court's decision, since taxpayer's method requires him to use § 722 before using

§ 713(e)(1), it is not an argument that the determination of the question is solely necessary by reason of § 722.

As indicated in Waters v. C. I. R., supra (160 F. 2d 598), we think that Congress, in enacting § 732(c), was "motivated by practical considerations in limiting review of issues * * *", raised under the section set out in § 732(c), and that the principal concern of Congress was that the abnormalities and unusual factual circumstances which give rise to relief under those sections should all "be decided by one group familiar with the problems involved." House Report 2333, 77th Congress, 2nd Session, quoted in Waters v. C. I. R., supra, footnote 7.

[2, 3] As to the scope of our review aside from § 732(c), we think we have here a pure question of law, and while we "attach weight to the decision of points of law by an administrative body having special competence to deal with the subject matter" (Dobson v. C. I. R., 320 U. S. 489, 502, 64 S. Ct. 239, 247, 88 L. Ed. 248), we nevertheless have jurisdiction to review "rules of general applicability [announced by the Tax Court] on clear-cut questions of law." Crane v. C. I. R., 67 S. Ct. 1047, 1055; Pohatcong Hosiery Mills v. C. I. R., supra.

[4] Turning to a consideration of the merits of this controversy, the answer to the problems lies (1) in the fact that two separate statutory concepts are involved, namely, "average base period net income" set out in § 713(e)(1), and "constructive average base period net income", found in § 722; (2) that in the event conditions permitting the use of the second concept are present, it is to be used "in lieu of" the first; and (3) that, therefore, both concepts cannot be used together.

The difference between the two concepts is revealed more clearly when it is remembered that the "average base period net income" is computed under § 713(e)(1) by automatic and inflexible methods. If certain conditions are

present (as they were here) the earnings for the lowest year are raised to an amount equal to 75% of the average of the other three years. This is always done, regardless of what caused the low earnings in the one year.

On the other hand "constructive average base period net income" is established by the *discretionary* use of rules and methods thought to be the best way of correcting abnormal and unusual events, peculiar to the individual taxpayer's experience.[5]

The earnings of virtually all corporations may have been low in 1938; if so, all are raised under § 713(e)(1). But because of the flexible methods available in § 722 cases, elements personal to the taxpayer may be considered and its true normal earnings may be more accurately measured.

Section 722 requires that a taxpayer not only show that the tax (computed without benefit or application of § 722) results in an excessive and discriminatory tax,[6] but he must also establish "what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period. * * *"

When no abnormalities have occurred in the base period,

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[5] See, E. P. C. 13, April 9, 1947, published in I. R. Bulletin No. 9, May 5, 1947, and P-H 1947 Fed. Tax Service, Par. 76,148. In this E. P. C., commenting on the Tax Court's decision in the instant case, it is said that in certain cases, parts of § 713 may be used in § 722 cases: "For example, the base period prescribed by § 713(b) is a device which is practical and appropriate to the determination of such a standard of earnings [the normal earnings of § 722], but the 75% rule, having no relationship to cause and effect, is not appropriate and will not be applied."

[6] Under § 722(b) the tax is considered excessive and discriminatory if it is shown, as taxpayer has shown here, that an event unusual in its experience occurred during the base year. Therefore, taxpayer has met the first requirement.

or other events unusual and peculiar in the experience of the taxpayer, then the averaging methods of § 713(e)(1) will produce a satisfactory method of determining average base period earnings. But if the taxpayer has had some abnormal events in its base period (such as the 1937 strike here), then taxpayer is required by § 722 to establish that which would be a fair and just amount representing normal earnings. That is a different concept than the automatic statutory formula of § 713(e)(1), which may or may not represent a "fair and just amount", since it requires an inflexible raising of the lowest year.

Taxpayer argues that there is no evidence that an average computed under § 713(e)(1) is *not* a fair and just amount. Conceding this to be true and that it is theoretically possible to use both sections, the fact remains that Congress has clearly provided in § 722 that a taxpayer must establish what *is* a fair and just amount representing normal earnings which he must then use as a "constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter." The only place the "average base period net income" is "otherwise determined [in the] subchapter" is § 713(e)(1).

There is no statutory authorization for using the 75% rule of § 713(e)(1) in computing the constructive average of § 722. On the other hand, we think there is a statutory prohibition against using both sections in that § 722 requires the constructive average to be used in lieu of the § 713 average.

[5] Here taxpayer has established what would be a fair and just amount representing normal earnings *for the year* 1937. He contends he may also raise his 1938 earnings by § 713(e)(1), but that which is automatically raised may not be a fair and just amount, and one must be used in lieu of the other. Our remaining inquiry is, what

constitutes the "fair and just amount representing normal earnings" which is to be used in lieu of the § 713(e)(1) average?

It seems clear that it means the *actual* earnings for each year in which no abnormality occurs, *and* the constructive earnings for years in which abnormalities, etc., within § 722* do occur, averaged together. This is the *constructive* average base period net income, and it is to be used in lieu of the § 713(e)(1) average which is designed to relieve automatically taxpayers who have no abnormalities or other events within § 722,* but who do have a year of low earnings.

The regulations covering this subject (S 35.722-2(b)(1) of Regulations 112) provide:

"§ 722(a) provides for the determination of a constructive average base period net income * * *. Therefore, in computing such amount a taxpayer is not entitled to use the rules provided by § 713(e)(1). * * * Since the constructive average base period net income is the fair and just amount representing normal earnings and will reflect adjustments for abnormally low base period years, a taxpayer having computed such amount is not entitled in addition to apply the rules provided by § 713(e)(1)."

These Regulations set forth a reasonable and correct interpretation of the law and taxpayer's contention that the Regulations are invalid cannot be sustained on any of the grounds urged.

Taxpayer assails the decision of the Tax Court on several additional grounds, which, insofar as it is necessary to consider them, may be summarized as follows:

1. § 722(b) "entitles" a taxpayer to use § 713.
2. By the 1942 amendments to § 722 Congress did not

* Shown as § 732 in 163 F. 2d 269, 275.

intend to deprive a taxpayer of his right, which existed under the 1941 Act, to use both § 713 and § 722.

3. The two sections are in pari materia, and must be construed together so as to give full effect to both.

4. The constructive average must be used since taxpayer has established the two conditions precedent to the use of § 722.

[6] First: Taxpayer's contention is that § 722(b) by providing that "The tax computed under this subchapter * * * shall be considered to be excessive * * * in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713 * * *", entitled it to use § 713.

We do not so read § 722(b). It merely provides that it applies to a taxpayer who is entitled to use the excess profits credit based on income, pursuant to § 713. There are two methods of computing excess profits credit: the income method, and the invested capital method (§ 714, et seq.). Not all taxpayers are *entitled* to use the "excess profits credit based on income", i. e., the income method. Under § 712, only domestic corporations in existence prior to January 1, 1940, are "entitled to use" both the income method of § 713 and the invested capital method. Other domestic corporations, and all foreign corporations must use the invested capital method.[7]

Section 722(b) is not authority for the proposition that a taxpayer is entitled to use both § 713(e)(1) and § 722; it merely refers to those corporations which are entitled to use the income method of § 713.

Second: It is true that § 722 in the 1941 Act did provide that the average base period net income, then to be determined under § 722 should be computed as in § 713.

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[7] Cf., Bickford, "Excess Profits Tax Relief", pp. 21, 22; 1944, Prentice-Hall.

It is also true that the 1942 version of § 722 entirely omitted this provision and instead required a "constructive average" to be used "in lieu of" the § 713 average.

Under these circumstances, and with such a drastic alteration of the law, a comparison of the two acts warrants the conclusion that Congress which, in 1941, had permitted the two sections to be used together, declared in 1942 that the sections were mutually exclusive.

[7] Taxpayer cites committee reports to show that the 1942 amendments were designed to broaden the relief granted under § 722; and cases holding that the repeal and simultaneous reenactment of substantially the same statutory provisions are to be construed as a continuation of the old statute. The statute being clear resort to extrinsic aids to construction is unnecessary.

It is contended that the "in lieu of" clause of § 722 leaves unanswered the question of whether the constructive average is an ordinary arithmetical average or an average computed under § 713(e)(1). We do not agree. The constructive average of § 722 is to be used in lieu of the § 713(e)(1) average; hence it cannot be the same average as that called for in § 713(e)(1).

Taxpayer also contends that the "in lieu of" clause means that constructive "earnings" are to be used in lieu of the actual earnings of § 713. But § 722 does not so read. To adopt taxpayer's argument would do violence to the statutory language found therein.

Third: Having held that § 713(e)(1) and § 722 refer to entirely different and mutually exclusive statutory concepts, it follows that rules relating to statutes in pari materia are not material. We repeat that the construction we adopt gives effect to § 722 when a constructive average is to be used, and to § 713(e)(1) when an average is to be used.

Fourth: Taxpayer argues that since it has established

both conditions precedent for the use of § 722, the tax must be determined by the constructive average. With this we agree.

But taxpayer goes further and contends that the constructive average must be computed in accordance with § 713(e)(1) because taxpayer will otherwise be left with a tax which the statute declares to be excessive and discriminatory. With this we do not agree. The fact that taxpayer has shown the abnormality for 1937 entitles it to correct its 1937 figures under § 722. If it does this the excess profits credit, computed without use of § 713(e)(1) turns out to be a lower figure in this case than if the § 713(e)(1) average is used without reference to § 722. But because that is the result of using § 722 alone here, it does not follow that such use of § 722 alone nullifies § 713(e)(1) in all cases, since in other instances where different earnings are involved, the use of § 722 alone would result in a higher excess profits credit than if § 713(e)(1) alone were used.[8]

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[8] See Treas. Dep't. Bulletin on § 722, as amended by E. P. C. 16, June 2, 1947, quoted in CCH Standard Excess Profits Tax Reporter, Vol. 3A—1946, pg. 8337, and pg. 9395-6, wherein it is said:

"Accordingly, the mere existence of an event or circumstance under § 722(b) does not automatically mean that the average base period net income is an inadequate measure of normal earnings. * * * But a taxpayer which has established the existence of one or more of the factors set forth in § 722(b) * * * may be denied relief without a detailed and exact determination of normal earnings when it is clear that without such a determination normal earnings [computed under § 722] would not exceed average base period net income [computed under § 713(e)(1)] * * *.

"There is no test of whether 'average base period net income is an inadequate standard of normal earnings' other than a comparison of average base period net income and constructive average base period net income."

Here a comparison of the two shows that the average base period net income of taxpayer is higher than its constructive average base period net income. It follows, under the Treasury Department Bulletin, that the average base period net income is not "an inadequate standard of normal earnings" in this case.

Appendix C

Although taxpayer has established an abnormality for 1937 and so should use § 722 in lieu of § 713(e)(1), which is for taxpayers who suffered no abnormalities during the base period, the Government has permitted taxpayer to use § 713(e)(1) instead of § 722.

Other contentions have been made. We have considered them and find them to be without merit.

The decision of the Tax Court is affirmed.

DOWD-FEDER, INC. v. COMMISSIONER OF INTERNAL REVENUE.

No. 10758.

United States Court of Appeals.

Sixth Circuit.

March 28, 1949.

On Petition to Review the Decision of the Tax Court of the United States.

Proceeding on the petition of Dowd-Feder, Inc., to review a decision of the Tax Court of the United States, 10 T. C. 345, redetermining a deficiency imposed by Commissioner of Internal Revenue in petitioner's income tax for 1941.

Affirmed.

M. R. Schlesinger, of Cleveland, Ohio (M. R. Schlesinger, of Cleveland, Ohio, and Grossman, Schlesinger & Carter, of Cleveland, Ohio, of counsel, on the brief), for petitioner.

Carlton Fox, of Washington, D. C. (Theron Lamar Caudle, Ellis N. Slack, Lee A. Jackson and Carlton Fox, all of Washington, D. C., on the brief), for respondent.

Appendix C

Before HICKS, Chief Judge, and SIMONS, and MARTIN, Circuit Judges.

MARTIN, *Circuit Judge.*

Dowd-Feder, Inc., has petitioned this court to review the decision of the United States Tax Court holding that there is a deficiency in the corporation's income tax for 1941 in the amount of $7,885.51. The case involves determination of the proper basis of computation of the taxpayer's excess profits credits.

The Tax Court held that there is no deficiency in excess profits tax for that year; but that where the amount of excess profits credits, computed by using average base period net income reconstructed under section 722 of the Internal Revenue Code, 26 U. S. C. A. §722, is less than the credit resulting from application of the 75 per centum rule under section 713(e)(1) to the actual base period net income, the taxpayer, as is the situation in the case at bar, is not entitled to relief under section 722 in addition to the benefits of section 713(e)(1). This holding was based on the authority of Stimson Mill Co. v. Commissioner of Internal Revenue, 9 Cir., 163 F. 2d 269, certiorari denied 332 U. S. 824, 68 S. Ct. 165, rehearing denied 332 U. S. 839, 68 S. Ct. 218, affirming 7 T. C. 1065. The two pertinent sections of the Internal Revenue Code are, in material part, set forth in the margin.[1] The case was tried in the Tax Court on a stipulation of fact.

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[1] Section 722. "General relief—Constructive average base period net income. (a) General rule. In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall

Appendix C

[1] From January 1, 1936, to the present time, Dowd-Feder, Inc., of Cleveland, Ohio, has been a distributor of Chrysler and Plymouth automobiles. As the result of a strike at the factories of the Chrysler Corporation from October 6th to November 28th, 1939, deliveries of new cars to its dealers were curtailed, in consequence of which Dowd-Feder, Inc., was unable to procure its normal allotment. The strike and the diminished operations resulting from it were "events unusual and peculiar in the experience" of the taxpayer, within the purview of section 722 of the Internal Revenue Code. Dowd-Feder, Inc., in January 1944, applied for relief under section 722 with respect to the calendar years 1941 and 1942. The taxpayer established to the satisfaction of the Tax Court that, as a re-

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be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. In determining such constructive average base period net income, no regard shall be had to events or conditions affecting the taxpayer, the industry of which it is a member, or taxpayers generally occurring or existing after December 31, 1939, except that, in the cases described in the last sentence of section 722(b)(4) and in section 722(c), regard shall be had to the change in the character of the business under section 722(b)(4) or the nature of the taxpayer and the character of its business under section 722(c) to the extent necessary to establish the normal earnings to be used as the constructive average base period net income. (b) Taxpayers using average earnings method. The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713; if its average base period net income is an inadequate standard of normal earnings because—(1) in one or more taxable years in the base period normal production, output, or operation was interrupted or diminshed because of the occurrence, either immediately prior to, or during the base period, of events unusual and peculiar in the experience of such taxpayer, * * *." 26 U. S. C. A. §722(a) and (b)(1).

Section 713(e)(1). "Average base period net income—general average: The average base period net income determined under this subsection shall be determined as follows: (1) By computing

sult of the Chrysler strike and the resultant interruption of its normal business, its actual earnings for 1939 were abnormally low, and that its actual average base period net income is an inadequate standard of normal earnings under the provisions of section 722(b)(1) of the Internal Revenue Code.

On January 30, 1945, the Commissioner of Internal Revenue issued a statutory notice determining that there is a deficiency in income tax liability of the petitioner for the year 1941 in the amount of $7,885.51, and that there was an over-assessment of excess profits tax liability for that taxable year in the amount of $6,552.18. In making this determination the application of the taxpayer for relief in 1941, under section 722, was partially allowed in the amount of $2,990.97 and disallowed to the extent of $1,933.51. The taxpayer has stipulated and agreed that the determination of the Commissioner that $61,010.60 represents a fair and just amount of normal earnings to be used as a constructive average base period net income, for the purpose of excess profits credit for 1941 only, under the provisions of section 722.

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the aggregate of the excess profits net income for each of the taxable years of the taxpayer in the base period, reduced by the sum of the deficits in excess profits net income for each of such years. If the excess profits net income (or deficit in excess profits net income) for one taxable year in the base period divided by the number of months in such taxable year is less than 75 per centum of the aggregate of the excess profits net income (reduced by deficits in excess profits net income) for the other taxable years in the taxpayer's base period divided by the number of months in such other taxable years (herein called 'average monthly amount') the amount used for such one year under this paragraph shall be 75 per centum of the average monthly amount multiplied by the number of months in such one year, and the year increased under this sentence shall be the year the increase in which will produce the highest average base period net income; (2) By dividing the amount ascertained under paragraph (1) by the total number of months in all such taxable years; and (3) By multiplying the amount ascertained under paragraph (2) by twelve." 26 U. S. C. A. §713(e)(1).

Appendix C

In its claim for refund of $10,313.57 for 1941, the taxpayer contends that it is entitled to an excess profits credit carry-back of the unused excess profits credit for 1942 in the amount of $29,894.40.[2] The contention is based upon the proposition that the excess profits credit for 1942 should be based upon a constructive average base period net income determined by applying both section 722 and the 75 per centum rule set forth in section 713(e)(1) of the Internal Revenue Code. Using this basis of computation, the petitioner contends that the allowable credit for 1942 should be $66,098.02. The Commissioner denied the contention and disallowed the claim for refund.

The Tax Court found that, in computing its excess profits tax for the taxable years involved, the petitioner is entitled to use an excess profits credit based upon net earnings within the base period years of 1936 to 1939, inclusive, in accordance with section 713 of the Internal Revenue Code, as amended. The Court pointed out that the Commissioner admits that the taxpayer's earnings for 1939 (prior to taxes) should be reconstructed under section 722 from the actual amount of $63,151.29 to the reconstructed amount of $88,338.43; and that the excess profits credit for 1942 would, by calculation, amount to $56,838.71.

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[2] Section 710(c)(3)(A). "Amount of unused excess profits credit carry-back and carry-over (A) Unused excess profits credit carry-back. If for any taxable year beginning after December 31, 1941, the taxpayer has an unused excess profits credit, such unused excess profits credit shall be an unused excess profits credit carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such unused excess profits credit over the adjusted excess profits net income for the second preceding taxable year computed for such taxable year (i) by determining the unused excess profits credit adjustment without regard to such unused excess profits credit, and (ii) without the deduction of the specific exemption provided in subsection (b)(1)." 26 U. S. C. A. § 710(c)(3)(A).

But the taxpayer contends that, in addition to the adjustment computed by the Commissioner under section 722, its excess profits credit for 1942 should be computed by the addition of an increase in the excess profits net income for the year 1938, under section 713(e)(1), which would raise the excess profits credit to $66,098.02. The petitioner stipulates and agrees that, unless it is entitled to the adjustment claimed under section 713(e)(1) for the base period year 1938, it is entitled to no further constructive adjustments to actual earnings for the base period years 1936, 1937 and 1938 under section 722 of the Internal Revenue Code as presently constituted.

[2] From the stipulation of facts adopted as findings by the Tax Court, it appears from the calculations therein, and is so declared, that inasmuch as the excess profits credit of $58,620.59, determined by averaging actual base period net income adjusted as to the year 1938 under section 713(e)(1), is *greater* than the excess profits credit computed by the use of an average based on actual excess profits net income for 1936, 1937, and 1938, and excess profits net income for 1939 reconstructed under section 722, relief under that section for the year 1942 should be and is denied.

The petitioner agrees that, if it is not entitled to relief under section 722 of the Internal Revenue Code in addition to the benefits contained in section 713(e)(1) of the Code, in computing the excess profits credit for the year 1942, the proposed deficiency and the over-assessment as set forth in the notice of deficiency of January 30, 1945, are correct and have been properly determined by the Commissioner.

In its opinion, the Tax Court states that the case has been considered in entirety by the Excess Profits Tax Council of the Bureau of Internal Revenue, which, on January 16, 1947, sustained the original determination

set forth in the statutory notice of deficiency issued by the Commissioner on January 30, 1945.

The argument of petitioner here is, upon analysis, the same as that made in behalf of the taxpayer in Stimson Mill Co. v. Commissioner, supra. The contention is that the taxpayer is entitled to obtain the benefits of both section 713(e)(1) and section 722, affording special discretionary relief. As was pointed out by the Court of Appeals for the Ninth Circuit, Congress has provided in section 722 that a taxpayer must establish a fair and just amount representing normal earnings which he must then use as a "constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter"; and that section 713(e)(1) is the only section of the revenue law where the "average base period net income" is otherwise determined in the subchapter. It is then reasoned, correctly we think, that there is no statutory authorization for using the 75 per centum rule of section 713(e)(1) in computing the constructive average of section 722; but, to the contrary, there is a statutory prohibition against using both sections, inasmuch as section 722 requires the constructive average to be used in lieu of the average provided for in section 713(e)(1). Moreover, we agree with the Court of Appeals that the Treasury Regulations relating to the subject matter constitute a reasonable and correct interpretation of the statutes: "Section 722(a) provides for the determination of a constructive average base period net income. * * * Therefore, in computing such amount a taxpayer is not entitled to use the rules provided by section 713(e)(1). * * * Since the constructive average base period net income is the fair and just amount representing normal earnings and will reflect adjustments for abnormally low base period years, a taxpayer having computed such amount is not entitled

in addition to apply the rules provided by section 713(e)(1)." Section 35.722-2(b)(1) of Regulations 112.

Inasmuch as we are in accord with the basis of decision of the Ninth Circuit and of the Tax Court whose opinion was affirmed, we find no occasion for rewriting and rejecting arguments made by the taxpayer in the instant case which have been considered in detail and rejected in those opinions. In all material aspects relating to the merits we are in accord with the reasoning of the Ninth Circuit upon the points presented.

The Commissioner of Internal Revenue has raised a more troublesome question by his motion to dismiss the petition for review on the ground that this court is without jurisdiction by reason of section 732(c) of the Internal Revenue Code, 26 U. S. C. A. § 732(c), which provides: "Finality of determination. If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of [two specified sections], *or section 722*, the determination of such question shall not be reviewed or redetermined by any court or agency except the Board." [Italics supplied.]

The ensuing section, 732(d), added by the Revenue Act of 1942, provides that the determinations and redeterminations by any division of the Board involving any question arising under section 722 and another specified section, with respect to any taxable year, shall be reviewed by a special division of the Board which shall be constituted by the Chairman and consist of not less than three Board members. The section concludes: "The decisions of such special division shall not be reviewable by the Board, and shall be deemed decisions of the Board." See 26 U. S. C. A. § 732. The Board of Tax Appeals is, as is well known, now the Tax Court of the United States.

The Government argues that no substantial question

has been or may be raised by the taxpayer under section 713(e)(1) of the Internal Revenue Code; and that there is nothing in the wording of that section, its legislative history, or the Treasury Regulations, which warrants the use in a computation made under it of a factor used by the Commissioner in determining whether and to what extent the taxpayer should be granted relief under section 722. It is pointed out that section 713(e)(1) came into the statute in 1942, when Congress enacted substantial changes in section 722; and that, if Congress had intended the interpolation of a special discretionary relief into a general statutory excess profits computation, such intention would have been manifested clearly in the statute. The point is emphasized that Congress, by expression, vested the administration of section 722 in the Commissioner and, by sections 732(c) and 732(d), expressly limited to the Tax Court review of the Commissioner's determinations; and that, by thus entrusting solely to the Commissioner and the Tax Court the grant of relief under section 722, and by the explicit provision that the decisions of the Commissioner and the Tax Court involving questions necessary to be determined solely by reason of that section should not be subject to appellate court review, Congress withdrew jurisdiction to review issues decided by the Commissioner and the Tax Court respecting the grant of relief under section 722.

Arguendo, the conclusion is drawn by respondent that whether a taxpayer may require the grant of relief under section 722 in addition to the benefits to be derived from 713(e)(1), and whether a taxpayer is entitled as a matter of right to read into section 722 the 75 per centum rule of section 713(e)(1), are questions the determination of which depends upon interpretation of section 722, and so are questions the determination of which is necessary solely by reason of section 722.

Appendix C

In support of its argument, the respondent cites a series of special assessment cases arising under statutes pertaining to excess profits taxes, wherein it was held that the federal appellate courts have no power to review determinations of the Board of Tax Appeals when no challenge for fraud or irregularities was made. Welch v. Obispo Oil Co., 301 U. S. 190, 57 S. Ct. 684, 81 L. Ed. 1033; Heiner v. Diamond Alkali Co., 288 U. S. 502, 53 S. Ct. 413, 77 L. Ed. 921; Williamsport Wire Rope Co. v. United States, 277 U. S. 551, 48 S. Ct. 587, 72 L. Ed. 985; Duquesne Steel Foundry Co. v. Commissioner, 3 Cir., 41 F. 2d 995, affirmed per curiam 283 U. S. 799, 51 S. Ct. 491, 75 L. Ed. 1422; Cleveland Automobile Co. v. United States, 6 Cir., 70 F. 2d 365, certiorari denied 293 U. S. 563, 55 S. Ct. 88, 79 L. Ed. 663.

In the last cited case, we reviewed the Supreme Court decisions and drew the conclusion that once the special discretionary power to grant relief under sections 327 and 328 of the Revenue Act of 1918, 40 Stat. 1093, is invoked and exercised, and no claim of fraud or other irregularity is asserted, neither the determination nor the factors used in computation, nor the result itself, is open to review. This court said: "We are not greatly impressed with the argument that the government's view of the special assessment provisions penalizes the taxpayer who resorts to them and compels him to gamble away a right to judicial review specially given him by statute for a blind remedy that may give him much less. The taxpayer is not compelled to invoke the relief sections of the statute. He has his right to judicial relief without resort to them, and whether he seeks such relief or the extraordinary relief which these sections afford, may perhaps depend upon the confidence he has in the merit of his grievance. Moreover, he has still his right of appeal from the findings of the Commissioner to the

Board of Tax Appeals [citing authorities], and such appeal being to an independent agency in the executive branch of the government, especially established to review the Commissioner's decisions, is not in conflict with the view that sections 327 and 328 preclude judicial review of the exercise of administrative discretion. Williamsport Co. v. United States, supra." 70 F. 2d 368.

[3] While the question of our jurisdiction to review the decision of the Tax Court in the instant case is close, we accord due weight to the decision of the Ninth Circuit Court of Appeals in the Stimson Mill Company case, supra [163 F. 2d 273], and have reached the conclusion that we should not depart from its rationale, thus stated: "It is of course possible to cast the problem, as the Government has done, solely in terms of § 722 by stating that taxpayer was allowed the benefits of § 713(e)(1) and that the only question is whether he is entitled to § 722 relief. But the nature of the § 722 relief sought by taxpayer should not be overlooked. Taxpayer concededly has established, under § 722, that its earnings for the year 1937 should be raised. Averaging said constructive 1937 earnings with taxpayer's actual earnings for the other three years of the base period (since taxpayer is not entitled to raise constructively its earnings for those other three years) would result in its excess profits credit being less than if its 1938 earnings are raised under § 713(e)(1) and its 1937 earnings are left unaffected by § 722. Taxpayer asks to raise both 1937 and 1938 earnings by the use of both sections. It was this double relief that the Government refused to allow, and the determination of that question clearly was necessary by reason of both sections. For were it not for § 713(e)(1) taxpayer could have no question as to his tax liability to be determined. By stipulation

he established the right to raise the 1937 figures under § 722, and by stipulation he was not entitled to raise other years under that section. The determination of his tax liability can be resolved only by the determination of a question arising under both sections, namely, whether taxpayer may raise his 1938 earnings under § 713(e)(1) by using the constructive earnings of one year computed under § 722. * * * It is true that § 722(d) requires a taxpayer to compute its tax without applying § 722, but while this may be an argument in favor of the Tax Court's decision, since taxpayer's method requires him to use § 722 before using § 713(e)(1), it is not an argument that the determination of the question is solely necessary by reason of § 722." 163 F. 2d 273. A pure question of law being presented, it was held that the decision of the Tax Court was reviewable by the Circuit Court of Appeals.

The motion of respondent for review is denied; and the decision of the Tax Court is affirmed.

PACKER PUB. CO., v. COMMISSIONER OF INTERNAL REVENUE.

No. 14678.

United States Court of Appeals,

Eighth Circuit.

Apr. 15, 1954.

Charles C. Shafer, Jr., Kansas City, Mo. (Lancie L. Watts, Kansas City, Mo., on the brief; Watts & Shafer, Kansas City, Mo., of counsel), for petitioner.

Harry Marselli, Sp. Asst. to Atty. Gen. (H. Brian Holland, Asst. Atty. Gen., Ellis N. Slack, Sp. Asst. to Atty. Gen., on the brief), for respondent.

Appendix C

Before GARDNER, Chief Judge, and JOHNSEN and COLLET, Circuit Judges.

COLLET, Circuit Judge:

The Packer Publishing Company duly filed its excess profits tax returns for the years 1943, 1944 and 1945. In those returns it did not claim any adjustments under § 711(b)(1)(J) of the Internal Revenue Code, 26 U. S. C. A. § 711.[1] In due time it made claims for refunds under § 711 for all three years. These claims were allowed in part by the Commissioner by stipulation. The taxpayer did not then nor does it now criticize the stipulated allowance. Thereafter, it filed claims for relief and refunds for each of the three years under § 722 of the Internal Revenue Code, 26 U. S. C. A. § 722. The Commissioner disallowed the claims under § 722.

Upon petition by the taxpayer to the Tax Court, that court allowed a portion of the claims by decision reported in Packer Publishing Co. v. Commissioner of Internal Revenue, 17 T. C. 882. The claims based on § 711 having been settled by stipulation between the taxpayer and the Commissioner, neither pleaded the basis for the stipulated allowance in the § 722 proceedings before the Tax Court. The exhibits filed in the Tax Court, made a part of the petition addressed to that court, showed, however, that an allowance had been made under § 711 and the calculations and computations in those exhibits were based upon that stipulated allowance. When the Tax Court granted relief under § 722 it directed that the Commissioner and the taxpayer undertake to make the computation of the amount of refund due and submit the result to the court. This pursuant to the Tax Court's Rule 50. When the Commissioner and the taxpayer undertook to do so, the

[1] Since the pertinent portions of § 711 will be referred to later, they are not set out here.

Commissioner took the position that the taxpayer could not be entitled to relief under both § 722 and § 711 and, since the court had directed relief under § 722, the Commissioner eliminated from consideration the relief theretofore granted by stipulation under § 711. The taxpayer contended that it was entitled to both. Each submitted to the court, under Rule 50, computations based upon its respective position. The dispute was heard by one judge of that court. The record shows that the judge concluded that the court was without jurisdiction to consider whether the taxpayer was entitled to any relief under § 711 in a proceeding for relief under § 722. This decision was made without inquiry into the basis for the claimed relief under § 711. Judgment was entered for the taxpayer upon the computation submitted by the Commissioner. That computation was correct if relief under § 722 necessarily and automatically excluded any relief under § 711. If that premise is not correct, the taxpayer has been denied the relief granted by the Commissioner by stipulation without any opportunity to be heard thereon by the Tax Court.

Also presented to the Tax Court in the § 722 proceeding was a claim for adjustment in the event relief was granted under § 722. Briefly, that claim was based upon the fact that one of the taxpayer's executives was paid upon a bonus agreement, the bonus to be a stipulated portion of net profits after taxes. If relief was granted under § 722, the taxes would be lower and the bonus greater. The claim was that the greater compensation to be paid the executive, in the event the bonus was automatically increased as a result of relief being granted under § 722, be treated as operating expense and the increase deducted from the taxable income of the corporate taxpayer. The Tax Court refused to consider this claim on the ground that it was without jurisdiction to grant such relief in a § 722 proceeding.

The Commissioner now seeks to sustain the Tax Court's

judgment upon the grounds that: (1) the Tax Court's judgment is not reviewable and the Commissioner's motion to dismiss on that ground should be sustained; (2) that if it is reviewable the judgment is correct, because in a § 722 proceeding the Tax Court's jurisdiction is strictly limited to issues arising under § 722 alone; (3) that the taxpayer did not plead the grounds upon which it was claiming the relief theretofore administratively granted by stipulation under § 711 and hence such relief could not be considered in the § 722 proceeding; (4) that in its petition for review of the Tax Court's judgment the taxpayer did not include in the errors assigned or points stated therein any reference to its claim to an increased deduction on account of the increased bonus compensation in the nature of salary to its executive. A motion was addressed to this court, prior to docketing and submission of this cause, for leave to include this additional point for presentation to this court. At that time the motion was denied without prejudice to its renewal at the time of argument and submission. It has been renewed and is before us for determination with the case.

The Commissioner's motion to dismiss is based upon § 732(c), which is as follows:

> "(c) Finality of determination. If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711(b)(1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Board." 26 U. S. C. A. § 732(c).

Broadly and generally stated, both § 722 and § 711 deal with determining the normal income base to be used for purposes of comparison with the income for the tax year

in question in order to determine the excess profits for a given year which were earned in addition to the normal or base period earnings. This for the purpose of determining the tax for that year. The provision of § 722 under which the Tax Court granted relief is § 722(b)(4), reading as follows:

> "(b) Taxpayers using average earnings method. The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713, if its average base period net income is an inadequate standard of normal earnings because—
>
> "(4) the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflect the normal operation for the entire base period of the business. If the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier time. For the purposes of this subparagraph, the term 'change in the character of the business' includes a change in the operation or management of the business, a difference in the products or services furnished, a difference in the capacity for production or operation, a difference in the ratio of nonborrowed capital to total capital, and the acquisition before January 1, 1940, of all or part of the assets of a competitor, with the result that the competition of such competitor was eliminated or dim-

inished. Any change in the capacity for production or operation of the business consummated during any taxable year ending after December 31, 1939, as a result of a course of action to which the taxpayer was committed prior to January 1, 1940, or any acquisition before May 31, 1941, from a competitor engaged in the dissemination of information through the public press, of substantially all the assets of such competitor employed in such business with the result that competition between the taxpayer and the competitor existing before January 1, 1940, was eliminated, shall be deemed to be a change on December 31, 1939, in the character of the business, or * * *."

Section 711(b)(1)(J), 26 U. S. C. A. § 711, under which relief was granted administratively by stipulation and later withdrawn by the Commissioner after the Tax Court had granted relief under § 722, is as follows:

"(b) Taxable years in base period.

"(1) General rule and adjustments. The excess profits net income for any taxable year subject to the Revenue Act of 1936 shall be the normal-tax net income, as defined in section 13(a) of such Act; and for any other taxable year beginning after December 31, 1937, and before January 1, 1940, shall be the special-class net income, as defined in section 14(a) of the applicable revenue law. In either case the following adjustments shall be made * * *.

"(J) Abnormal deductions. Under regulations prescribed by the Commissioner, with the approval of the Secretary, for the determination, for the purposes of this subparagraph, of the classification of deductions—

"(i) Deductions of any class shall not be allowed

if deductions of such class were abnormal for the taxpayer, and

"(ii) If the class of deductions was normal for the taxpayer, but the deductions of such class were in excess of 125 per centum of the average amount of deductions of such class for the four previous taxable years, they shall be disallowed in an amount equal to such excess." 26 U. S. C. A. § 711(b)(1)(J).

[1] It is obvious, from the above quoted portions of § 722 and § 711 that the application of the formulae for determining normal or base period income is a complicated process. Reference to the remainder of both sections not quoted herein makes that fact more certain. It is safe to say from the proceedings in Congress incident to the enactment of § 732(c) and the language of the latter section, heretofore quoted, that the congressional intent and purpose was to provide that the application of the formulae set out in § 722 and § 711 (and § 721, not now directly involved) should be finally reviewed by the experts in that field,—the Tax Court. The Commissioner contends that such finality of review by the Tax Court extends not only to the ascertainment of whether the facts in a particular case warrant relief under those sections, but also to the legal construction of those sections for the purpose of determining whether relief granted under § 722 automatically precludes and is in lieu of any and all relief which is provided for by § 711. The cases of Colonial Amusement Co. v. Commissioner, 3 Cir., 173 F. 2d 568; Colorado Milling & Elevator Co. v. Commissioner, 10 Cir., 205 F. 2d 551; George Kemp Real Estate Co. v. Commissioner, 2 Cir., 182 F. 2d 847; James F. Waters, Inc. v. Commissioner, 9 Cir., 160 F. 2d 596, are cited in support of that position.

[2] An examination of these authorities discloses that neither of them holds that a review of the question pre-

sented here is barred by § 732(c). In each of those cases the question determined by the Tax Court was whether, under the facts, relief under § 721, § 722, or § 711 was appropriate. It is true that in the Kemp case the court stated that the language of § 732(c) "forbids any judicial review, whether of fact or law." [182 F. 2d 849.] But that statement was made in answer to a contention that § 732(c) should not be construed to forbid appellate review of questions of law when there were no *disputed* questions of fact. That presented an entirely different situation from that which is before us. There the facts were before the Tax Court. They were considered and the formulae of § 721 and § 722 were applied by that court with the result that it was determined the facts justified no relief under the law. Here the Tax Court declined to consider whether relief was appropriate under § 711, not because the facts did not justify relief, but because that court concluded the proper judicial construction of § 722 and § 711 must result in a holding that the granting of any relief under § 722 automatically precluded any consideration of relief under § 711, and hence no consideration could be given a claim for relief under § 711 in a § 722 case. That decision involved solely the judicial construction of the statute. It did not involve to any extent the determination of whether the formula of the statute, applied to the facts by the experts, justified or did not justify relief. The facts were not before the court and the taxpayer was prevented from presenting them by the court's construction of the statutes. Such a decision of the Tax Court is not within the purview of the prohibition of § 732(c). Cf. Dowd-Feder, Inc. v. Commissioner, 6 Cir., 173 F. 2d 673; Stimson Mill Co. v. Commissioner, 9 Cir., 163 F. 2d 269.

We are not confronted with the necessity of determining the propriety of a denial of relief by the Tax Court under § 711 upon the ground that such relief, if any was

merited, was included in the relief given under the broad scope of § 722, or upon any other ground involving the merits or the facts upon which a claim under § 711 is based. As we have undertaken to make clear, our problem is to determine whether the Tax Court was precluded by § 722 and § 711 from entertaining jurisdiction of the merits of the claim made and granted by stipulation under § 711 in a proceeding instituted under § 722.

[3] Granting that both sections are relief provisions and are to be strictly construed to the end that the relief intended should not be extended beyond the clear intent of the law as written, yet such construction should not be unreasonable or arbitrary.

In Mutual Lumber Co. v. Commissioner, 16 T. C. 370, the Tax Court held (with three judges dissenting) that in a case arising under § 722 it had no jurisdiction to consider an issue other than one arising under § 722. In H. Fendrich, Inc., v. Commissioner, a similar ruling was made. The latter case was reversed in H. Fendrich, Inc., v. Commissioner, 7 Cir., 192 F. 2d 916, decided November 16, 1951. In the case of City Machine & Tool Company v. Commissioner, 6 Cir., 194 F. 2d 535, decided February 22, 1952, the Tax Court had followed the rule it announced in Mutual Lumber Co. v. Commissioner and H. Fendrich, Inc., v. Commissioner. The Commissioner confessed error and the Court of Appeals (6 Cir.) reversed, following H. Fendrich, Inc., v. Commissioner (7 Cir.).

In the case of Jefferson Amusement Co. v. Commissioner, 18 T. C. 44, decided April 9, 1952, and East Texas Theatres v. Commissioner, 19 T. C. 615, decided December 31, 1952, the Tax Court followed the decisions of the Courts of Appeals for the Sixth and Seventh Circuits in the City Machine & Tool Company and the Fendrich cases.

[4] The hearing on the merits of the claim under § 722 was held in November, 1950. The record appears to have been closed April 9, 1951. Although the findings and opinion were not filed until November, 1951, apparently that opinion was rendered before the decision of the Fendrich case, November 16, 1951. When the hearing was held in March, 1952, by the trial judge, on the dispute arising at the conference of the parties under Rule 50, the hearing judge considered the Fendrich case but concluded that the Mutual Lumber case, supra, was the law of this case, the opinion of the Tax Court in the § 722 case having been theretofore filed. Whether the trial judge should have reached that conclusion is of no present importance, for we must now determine the correctness of the judgment of the Tax Court and the decision reached in the Fendrich and City Machine & Tool Company cases, supra, by the Courts of Appeals for the Sixth and Seventh Circuits. We find no fault with those cases. The principle decided in both is correct and controlling here. In both of them those courts reached the conclusion that the Tax Court had jurisdiction to consider issues arising under other parts of the Internal Revenue Code in a proceeding arising under § 722.

The argument is made by the Commissioner that the facts showing the grounds upon which relief was sought (and which had been granted by stipulation) under § 711 should have been pleaded by the taxpayer in its petition to the Tax Court for relief under § 722, and not being pleaded, no relief could be granted under § 711. The taxpayer contends that since the relief under § 711 had been granted by the Commissioner and was no longer in dispute, if the Commissioner considered that relief a bar to or a duplication of the relief sought in the petition for § 722 relief, that fact should have been pleaded as an affirmative defense by the Commissioner and that not having been done, any such defense is now waived.

[5, 6] We are not impressed with the value or desirability of making hard and fast pronouncements concerning procedural practices which experience has taught and formal rules of procedure contemplate should be left sufficiently elastic to enable trial courts to exercise a large degree of discretion in the administration of substantial justice. Formal rules of procedure are necessary and desirable in order that litigants may have an authoritative guide in a proper course to be safely followed to obtain a determination of the merits of their controversy. They should not be made the means of entrapping a litigant, whereby he loses his opportunity to present his cause on its merits. The Tax Court did not do this. It did not reach the question. Since the cause must be remanded, it is sufficient for present purposes to observe that if the formal pleading of additional facts be deemed necessary by the Tax Court for the clarification and presentation of this issue, leave should be granted to make appropriate amendment to the pleadings.

From what has already been said it must follow that the taxpayer's motion for leave to include in the errors assigned the point that the Tax Court had jurisdiction to pass upon the claim for an increased deduction on account of an increase in the compensation of the taxpayer's executive should be granted. It is granted. We agree with the statement of the Senate Finance Committee and the Court of Appeals for the Seventh Circuit in H. Fendrich, Inc., v. Commissioner, 192 F. 2d 916, 920, that:

> "* * * it is essential that all such issues be decided by one group familiar with the problems involved. Only by this method can a consistent and uniform application of the principles established be assured in all cases. At the same time there is provided [by the

statute] flexible machinery to coordinate cases involving both relief and abnormality issues as well as other questions.'"

The petitioning taxpayer requests that we direct the entry of a judgment allowing the relief claimed under § 711. A consideration of the merits of that claim and the facts upon which it is based, in the light of the relief granted under § 722, is essential to a determination of whether relief under § 711 is appropriate, in addition to that granted under § 722. That is for the Tax Court to determine, both from necessity in this case, and also because of the direction of the statute.

For the reasons stated, the cause is remanded to the Tax Court for its determination of the taxpayer's right to relief under § 711, and the propriety of an additional deduction on account of an increase in the compensation of the taxpayer's executive, occasioned by the decrease in taxes resulting from such relief as may be granted by the Tax Court.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. 520

CORN PRODUCTS REFINING COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. 457

CORN PRODUCTS REFINING COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE PETITIONER

Corn Products Refining Company prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above entitled consolidated cases on the 25th day of August, 1954. A petition for rehearing was denied September 27, 1954.

This is a reply brief to the memorandum for the respondent.

Commodity Futures Transactions

On the issue of whether Petitioner's dealings in commodity futures resulted in capital gains and losses or

ordinary income and deductions, Respondent, in his memorandum, makes two points:

> (1) That the decision of the court below was correct because the "taxpayer's purchases of futures did not constitute speculative transactions but were availed of in order 'to obtain business protection and to insure the profitable conduct of the business,' and that while not conforming to the technical definition of hedging, taxpayer's transactions were 'an integral part' of its manufacturing business and therefore comparable to hedges." and
>
> (2) That the decision of the court below is not in conflict with the cases of *Makransky* v. *Commissioner*, 154 F. 2d 59, *Commissioner* v. *Farmers and Ginners Cotton Oil Co.*, 120 F. 2d 772, and *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33.

While the first point made by Respondent seems clearly irrelevant on a Petition for Certiorari, the complete answer to it is found in the *Makransky*, *Farmers and Ginners Cotton Oil Co.* and *Trenton Cotton Oil Co.* cases (*supra*), on which Petitioner herein relies. The facts in those cases indicate that, in the words of Respondent quoted above, the purchases of futures did not constitute speculative transactions, were availed of in order to obtain business protection and to insure the profitable conduct of the business, and, while not conforming to the technical definition of hedging, were an integral part of the business. The taxpayers in those cases engaged in commodity futures transactions in an attempt to meet a business situation that was facing them. They were trying to minimize the risk of loss in their business and thus to stabilize their profits, and, in the course of so doing, they were exercising what they considered sound business judgment. Unfortunately, both businesswise and taxwise, their operations did not amount to hedging and, as a consequence, the losses resulting from their

operations were held by the several Circuit Courts of Appeal to be capital losses and not ordinary deductions.

The second point made by the Respondent will not bear scrutiny.

Respondent distinguises the *Makransky* case on the ground that that case "involved only an isolated instance in dealings in futures and not as here the consistent practice of a manufacturer availing itself of regular and continuous dealings in futures 'for the purpose of stabilizing inventory costs.'"

While the futures purchases in the *Makransky* case were not many in number, actually they represented a completely integrated attempt on the part of a manufacturer to meet, for an entire year a business situation that was facing him as a result of war conditions, *i. e.*, a shortage of raw materials. As to whether the futures purchases were entered into for the purpose of stabilizing inventory costs, the fact is that they were entered into for the purpose of insuring availability of inventory and obviously cost must have been a prime consideration. In the instant case, Petitioner while engaging extensively in futures purchases did not do so continually but rather from time to time as situations developed and to meet those situations.

The Respondent concludes his remarks about the *Makransky* case by saying that the Tax Court found that the taxpayer there had not, in fact, hedged. That, of course, is the Petitioner's point in the instant case. It had not hedged.

All the Respondent says about the *Farmers and Ginners Cotton Oil Co.* case and the *Trenton Cotton Oil Co.* case is that the taxpayers in those cases had not in their futures purchases effected a hedge. That again is the

position of the Petitioner in the instant case. It had not in its operations effected a hedge, and, consequently, it seeks the same tax treatment for the results of its operations as was afforded to, or rather was imposed upon (since it was to Respondent's advantage to take that position), the taxpayers in those cases.

Respondent closes his remarks on this issue by stating that the fact that the Petitioner achieved only partial protection (protection against increases in the price of corn but not decreases) was not significant, since complete or only partial insurance is simply a difference in degree and not in kind. Whether the difference is called one of degree or one of kind would seem to be a matter of semantics, but to say that there is no significance in the difference, however labelled, is to deny the facts of business life. This is particularly true where, as in the instant case, there is protection against a price increase but not against a price decrease, and a price decrease is just as apt to occur as a price increase. Where there is a hedge, there is protection against both increase and decrease. Where there is not such protection, there is no hedge. That is the test that was applied in the *Makransky, Farmers and Ginners Cotton Oil Co.* and *Trenton Cotton Oil Co.* cases (*supra*), and that is the test that was not applied in the instant case. Therein lies the conflict.

Jurisdiction of this Court and of the Court of Appeals

As to the fourth issue, the Respondent's argument (page 17 of his memorandum) that the Tax Court's decision was correct is of no relevance here. The sole question is whether the Court of Appeals had jurisdiction to review the decision of the Tax Court. Contrary to what the Respondent says, there *is* a conflict between the decision below and the decisions of the Courts of Appeal in *Stimson Mill Co.* v. *Commissioner*, 163 F. 2d 269

(C. A. 9th), certiorari denied, 332 U. S. 824, rehearing denied, 332 U. S. 839; *Dowd-Feder, Inc.* v. *Commissioner*, 173 F. 2d 673 (C. A. 6th) and *Packer Pub. Co.* v. *Commissioner*, 211 F. 2d 612 (C. A. 8th). In each of these cases as in the present case, there was involved not the question of whether Section 711, 721 or 722 of the Internal Revenue Code of 1939 was applicable but rather whether the Appellate Court could review the Tax Court's decision with respect to a collateral consequence of the application of one of these sections; and in each of the cited cases, it was held that the Appellate Court did have power to review.

CONCLUSION

The petition for a writ of certiorari, as prayed for by petitioner, should be granted.

Respectfully submitted,

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Dated: January 4, 1955.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 20

CORN PRODUCTS REFINING COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

(Consolidated Proceedings.)

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

Statement

The facts with respect to the issues have been previously brought out at pages 5 through 11 of petitioner's initial brief and pages 3 through 11 of respondent's brief. They will not be further set forth in this Reply Brief except to correct two misleading impressions contained in the respondent's brief.

a) Petitioner's sales policy, which was uniform in all years here in question, permitted the buyer to pay

the *lower of two prices, the contract price or the market price on the date of delivery* (Exhibit 10, R. 67, 105 and 203). Petitioner also had the *policy of permitting its customers to cancel unexecuted portions of orders* for cerelose or feed in their discretion. The Tax Court so found (R. 203). These cancellations were frequent, unpredictable, and at times substantial (R. 69). Respondent in footnote 19 at page 41 of his brief questioned the correctness of this assertion. However, the record discloses (R. 69) that 11.1% of the cerelose orders in 1939 were cancelled. In 1940, 62% of cerelose orders were cancelled. Cerelose, which is a corn sugar, represented almost 16% of petitioner's business in those years (R. 69).

b) One other misleading impression requires correction. Respondent stated at page 8 of his brief that the proceedings brought against petitioner in 1940 by the Commodity Exchange Authority were dismissed because petitioner was upheld in its contentions. The record does not support this statement. Frank H. Hall, a Vice President of the petitioner, testified (R. 72) that the complaint was withdrawn and the action dismissed. There was no decision of the Commodity Exchange Authority on the merits. The fact is that petitioner had commenced to liquidate its futures position with the advent of World War II. (See Commissioner's Chart No. 1 following page 67 of respondent's brief.) The question had simply become moot. This is further borne out by the fact that when Petitioner resumed futures purchases after

the war, the Commodity Exchange Authority commenced a similar action which resulted in a decision against petitioner. *In re Corn Products Refining Co.*, 13 Agric. Dec. 1117 (1954).

There is no dispute about the balance of the facts in this proceeding.

ARGUMENT

I

Petitioner's commodity futures transactions were capital asset transactions under the Internal Revenue Code of 1939.

A. Section 117(a) of the Internal Revenue Code governs petitioner's commodity transactions.

Respondent's argument on this point generally seems to be as follows (Br. 16-30):

> Although Section 117(a) is specific and unambiguous and includes within its provisions *specific* directions as to the tax treatment of *all* assets *whether or not connected with a trade or business* the section doesn't quite mean what it says. Thus the petitioner's corn futures, implicitly capital assets under the statute, should be treated as other than capital assets, even though the statute permits no such exception.

Petitioner contends that its commodity futures transactions fall within the scope of Section 117(a). That section defines capital assets in a manner which respondent states is unusual (Respondent's Brief, page 18). In point of fact, the method of definition is to set forth a general rule that all assets are capital assets *whether or not connected with the taxpayer's trade or business* unless they fall within the specific enumerated exclusions. Assets used in hedging transactions do not fall within any of these exclusions. Where a statute sets up a general rule and enumerates specific exceptions, as a matter of statutory construction further exceptions by way of *mere implication* are not permissible. *Richfield Oil Corporation* v. *State Board*, 329 U. S. 69 (1946); *Moore Ice Cream Company* v. *Rose*, 289 U. S. 373 (1933); *Cunard S. S. Co.* v. *Mellon*, 262 U. S. 100 (1923); *Addison* v. *Holly Hill Co.*, 322 U. S. 607 (1944); *Brooks* v. *St. Louis-San Francisco Ry. Co.*, 180 F. 2d 185 (8th Cir., 1950).

1. Legislative History and Intent: Section 117(a) Means What It Says

The general statutory distinction between capital and non-capital assets first appeared in Section 206(a) of the Revenue Act of 1921:

> "The term 'capital assets' as used in this section means property acquired and held by the taxpayer for profit or investment for more than two years (whether or not connected with his trade or business), but does not include property

held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year."

This concept was continued with slight modifications in the Revenue Acts of 1924, 1926, 1928 and 1932. In 1934 the specific exclusions above were made even more precise by eliminating the holding period test and adding the matter italicized below:

"Section 117. Capital Gains and Losses.

(b) Definition of Capital Assets.—For the purposes of this title, 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale *to customers* in the *ordinary* course of his trade or business."

The purpose of inserting the concept "to customers in the ordinary" is clearly set forth in the Committee Report:

"* * * The Senate amendment confines the exclusion to property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, thus making it impossible

to contend that a stock speculator trading on his own account is not subject to the provisions of section 117. The House recedes." (p. 22). Report—Conference Committee (73d Cong., 2d Sess., H. Rept. 1385).

In this connection it should be noted that the commodity futures in this case were not held by petitioner for sale to customers (R. 32).

That Congress was disturbed by the impossibility of a taxpayer getting a full deduction for a legitimate loss on the sale of a business asset is amply demonstrated by the following:

"Mr. Reed. * * * We have been trying to work out some method by which credits could reasonably be given for obsolete property which is sold for salvage. As will be seen, under this amendment, the only loss that is deductible is a loss on property normally carried for sale to customers. It is conceivable that a railroad company, for example, finds that while a locomotive is useless, it has a salvage value as scrap. Probably most of the deductions can be taken in the annual deductions for obsolescence, but if there remained a loss between the book value of such a locomotive and the amount for which it was sold to the junk dealer, under this language the loss could not be deducted. * * *" (p. 5962). Discussion—Senate (Cong. Rec. Vol. 78):

The problem to which Senator Reed referred above, was handled by making further precise exclusions in the 1938 and 1942 Acts to the statutory definition of capital assets when the exclusions for depreciable property and land used in a business were added.

These changes over the years amply demonstrate Congress's meticulous attention to precision in the definition of capital assets and the exclusions therefrom.

2. Statutory Reenactment Gives the Regulations Legislative Sanction

The phrase, "whether or not connected with his (taxpayer's) trade or business", has appeared in every Revenue Act since 1921 as a part of the definition of capital assets. Respondent has recognized this in his regulations throughout past years. For example in the regulations governing the distinction between capital and ordinary assets the phrase is quoted from the various pertinent Revenue Act sections, and appears in the following:

Reg. 62 Art. 1651, 1921 Revenue Act
Reg. 69 Art. 1651, 1926 Revenue Act
Reg. 74 Art. 501, 1928 Revenue Act
Reg. 77 Art. 501, 1932 Revenue Act

While the phrase itself was omitted from Reg. 86 (the Revenue Act of 1934), Reg. 94 (the Revenue Act of 1936), Reg. 101 (Revenue Act of 1938) and Reg. 103 (Internal Revenue Code of 1939), the

concept was expressed in the following manner in those Regulations:

> "The term 'capital assets' includes all classes of property not *specifically* excluded by Section 117(a)(1)." (Emphasis supplied.)

The definition contained in the regulations set forth so often repeated must be deemed to have received legislative sanction. *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 114-115 (1939); *National Lead Co.* v. *United States*, 252 U. S. 140, 146-147 (1920); *Commissioner* v. *Wheeler*, 324 U. S. 542, 547, fn. 10 (1945).

3. *Burnet* v. *Harmel* Does Not Support Respondent

Burnet v. *Harmel*, 287 U. S. 103 (1932), cited by respondent at pages 12, 19, *et seq.*, of his brief does not support the proposition that Section 117(a) is to be construed narrowly. That case specifically dealt with Section 208(a)(1) of the Revenue Act of 1924 wherein capital assets were defined in terms of a two-year holding period. The Revenue Act of 1934 abandoned the prior definition in enacting Section 117(b) "Definition of Capital Assets". The holding period no longer determined whether an asset is classified as capital or non-capital. All assets have since been designated as capital assets, *whether or not connected with taxpayer's trade or business*, unless specifically excluded.

The change in the statute would render *Burnet* v. *Harmel*, 287 U. S. 103 (1932) inapposite even if it

stood for the legal conclusion which respondent contends it does, but which petitioner denies. This Court there held that bonus payments received in addition to royalties in connection with an oil *lease* constituted ordinary income in the form of *rent*. The payments were required whether or not title technically passed to the oil in place on the execution of the lease; for this reason this Court held the transaction was not a sale. The Court did not thereby hold or even suggest that Section 208(a)(1) of the Revenue Act of 1924 defining "capital assets" was to be narrowly construed as respondent would have this Court believe. On the contrary this Court recognized the intent of Congress to relieve capital gains from high surtaxes, stating:

> "The provisions of the 1921 Revenue Act for taxing capital gains at a lower rate, re-enacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions. House Report No. 350, Ways and Means Committee, 67th Cong., 1st Sess. on the Revenue Bill of 1921, p. 10; see *Alexander* v. *King* (C. C. A.) 46 F. (2d) 235, 74 A. L. R. 174."

Respondent in interpreting *Burnet* v. *Harmel*, 287 U. S. 103 (1932), argues, at page 12 of his brief, that "the capital asset definition shall be broadly applied so as not to frustrate the Congressional purpose of

limiting the preferential treatment to property in the nature of investments, not employed as an integral part of the day-to-day income producing activity of the taxpayer".

On the other hand, respondent overlooks that the application of capital treatment is a penalty to the taxpayer in loss cases since loss deductions are limited thereby. Congress, in enacting the 1921 Act in the Report of the Ways and Means Committee, considered the loss aspect of the section more important than the gain aspect. For instance, the Ways and Means Committee of the House, in its Report (67th Congress, First Session, House Report 350) said:

> "It is believed that the passage of this provision would materially increase the revenue, not only because it would stimulate profit-taking transactions but because the limitation of 15 per cent is also applied to capital losses. Under present conditions there are likely to be more losses than gains" (pp. 10-11).

It should be further noted that the result forecast by Congress, as shown in the quotation above, has been eminently accurate in tax cases relating to hedging. In practically all the litigated cases the argument was addressed to loss treatment. Respondent's argument as to preference falls by its own weight when all aspects of capital asset treatment are considered.

4. The Present Case Does Not Involve an Attempt to Convert Ordinary Income to Capital Gain

The other cases cited by respondent in support of his theory of narrow and strict construction at pages 21 and 22 of his brief (*Kieselbach* v. *Commissioner*, 317 U. S. 399 (1943); *Hort* v. *Commissioner*, 313 U. S. 28 (1941); *Helvering* v. *Smith*, 90 F. (2d) 590 (2nd Cir., 1937); *Doyle* v. *Commissioner*, 102 F. (2d) 86 (4th Cir., 1939); *Rhodes' Estate* v. *Commissioner*, 131 F. (2d) 50 (6th Cir., 1942); *Fisher* v. *Commissioner*, 209 F. (2d) 513 (6th Cir., 1954), certiorari denied, 347 U. S. 1014 (1954); *Shuster* v. *Helvering*, 121 F. (2d) 643 (2nd Cir., 1941)) all involved attempts to convert ordinary income to capital gain by the sale or assignment of the right to receive it or the proper allocation of lump sum payments between proceeds of sale of capital assets on the one hand and ordinary income from services rendered or rental income on the other. In *Lucas* v. *Earl*, 281 U. S. 111 (1930), this Court had held that income is taxable to the person earning it and may not be assigned before receipt to convert it into a capital asset. The present case does not involve any such attempt to convert future income to capital gain. Here we are only concerned with purchases and sales of corn futures contracts which are admittedly capital assets (cf. Respondent's Brief, page 19).

Superficially the other cases cited by respondent, involving costs connected with the acquisition and dis-

posal of capital stock in whiskey distilleries (Respondent's Brief, pages 22-23) in order to acquire inventory, appear to be in point, but they are not. In each one of these cases inventory assets were acquired by the taxpayer by means of capital asset acquisitions, followed by the disposal of the stock. The instant case does not involve the acquisition of inventory assets but only futures contracts not held for sale to customers. (*Western Wine & Liquor Co.*, 18 T. C., 1090 (1952), appeal dismissed, 205 F. (2d) 420 (8th Cir.); *Clark* v. *Commissioner*, 19 T. C. 48 (1952), appeal dismissed June 18, 1953 (9th Cir.), and *Hogg* v. *Allen*, 105 F. Supp. 12 (M. D., Ga.), affirmed on this point, *sub nom.*, *Edwards* v. *Hogg*, 214 F. (2d) 640 (5th Cir., 1954)).

Despite all of the cases cited, respondent can only find one case in point which supports the theory he wishes to advance here. It is *Commissioner* v. *The Bagley & Sewall Co.*, 221 F. (2d) 944, 947 (2nd Cir., 1955), with which petitioner emphatically disagrees.

The precise reasons for disagreement are set forth at length in petitioner's initial brief at page 39 where it quotes in part Judge Frank's dissenting opinion in that case. Congress has nowhere stated or even indicated in enacting Section 117(a) or its predecessors that the purpose to which capital assets are put in any way changes their tax consequences. Congress has consistently defined capital assets to be *all assets whether or not used in the taxpayer's trade or busi-*

ness, unless they fall within the specific enumerated exclusions. *Richfield Oil Corporation* v. *State Board*, 329 U. S. 69 (1946); *Moore Ice Cream Company* v. *Rose*, 289 U. S. 373 (1933); *Cunard S. S. Co.* v. *Mellon*, 262 U. S. 100 (1923); *Addison* v. *Holly Hill Co.*, 322 U. S. 607 (1944); *Brooks* v. *St. Louis-San Francisco Ry. Co.*, 180 F. 2d 185 (8th Cir., 1950).

5. Assets Used in Hedging Are Not Excluded from Capital Assets

Respondent slides up to petitioner's proposition that hedging is not a proper exception to Section 117 in a rather oblique manner. Having contended (and we believe erroneously as we have discussed above) that there are additional exclusions to Section 117(a) other than the precise exclusions listed in the statute, he merely says in effect that this is just another one.

He again cites *Burnet* v. *Harmel*, 287 U. S. 103, 108 (1932); this time, however, suggesting a broad rather than narrow construction, he uses it to support his contention that not to permit the hedging exception "would have tended to defeat rather than further the purpose of the Act".

Respondent then cites all the cases in which G. C. M. 17322 (XV-2 Cum. Bul. 151) were involved in litigation as examples of the courts looking to the underlying purpose of the capital gains provision in interpreting Section 117. Petitioner has again reviewed those cases and nowhere do we find support for

respondent's implication or inference. An examination of these cases in detail will emphasize how narrowly and precisely the hedging rule has been applied by the lower courts, and it is noted that respondent has never discussed those decisions for the precise reason that they are precedents against his contentions in Section B of his brief (p. 31).

Respondent then makes the point that Congress has recognized that Section 117 does not apply to hedging transactions, by referring to the exclusions of hedging transactions from the general rule of Section 1233(a) of the 1954 Revenue Code. It is true that Section 1233(a) of the 1954 Code excepts hedging transactions in commodity futures from the operation of the short-sale rule. Section 1233 is the successor to Section 117(g) and Section 117(l) of the 1939 Code. It is not the successor to Section 117(a). It, therefore, becomes doubly significant that, while Congress made hedging an exception to the short-sale rule in enacting Section 1233 in 1954, it did not make any such exception in its exclusions from the definition of capital assets in Section 1221,[1] the successor to Section 117(a).

Congress has had repeated opportunities since 1934 to exclude *assets used in hedging transactions* from its definition of capital assets in each and every Revenue Act following that year. It has failed to do so. Congress at all times was cognizant of the

[1] Section 1221 of the 1954 Code: Appendix A, page 35.

concept of hedging as is seen in its treatment of profits from hedging transactions for personal holding company purposes in Section 502(c) of the Internal Revenue Code of 1939.

Congress set up a general definition in Section 117(a). It made specific exclusions therefrom. Congress has amended those exclusions from time to time. Congress has known that capital assets are and have been used in hedging transactions, but has not seen fit to make capital assets so used the subject of an additional exclusion. Every canon of statutory construction forbids an additional exclusion from being implied.

It is true, as respondent contends at pages 25 and 26 of his brief, that in the years following General Counsel's Memorandum No. 17322 (XV-2, C. B. 151 set forth at length at page 16 of petitioner's initial brief), the lower courts have applied that ruling to commodity transactions.[2] However, this Court has never passed upon the validity of G. C. M. No. 17322. The taxpayers, in those cases, claiming ordinary losses in their commodity transactions sought to take advan-

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[2] *Ben Grote*, 41 B. T. A. 247 (1940); *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F. (2d) 772 (5th Cir. 1941), cert. denied, 314 U. S. 683 (1941); *Kenneth S. Battelle*, 47 B. T. A. 117 (1942); *Tennessee Egg Co.*, 47 B. T. A. 558 (1942); *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. (2d) 33 (6th Cir. 1945), affirming T. C. Memo Op. (Dec. 28, 1943); *Estate of Dorothy Makransky*, 5 T. C. 397 (1945), aff. 154 F. (2d) 59 (3rd Cir. 1946); *Stewart Silk Corp.*, 9 T. C. 174 (1947); *Fulton Bag & Cotton Mills*, 22 T. C. 1044 (1954).

tage of G. C. M. No. 17322. Consequently, they did not wish or feel impelled to question the concept of hedging as an exception to Section 117(a).[3] The Commissioner, on the other hand, since he had issued the ruling, felt himself bound by his own ruling. Significantly, however, this General Counsel's Memorandum was never promulgated into regulation by the Commissioner. It, therefore, is not supported by the reenactment of Section 117(a). The present case presents the first opportunity for a taxpayer to challenge the validity of G. C. M. No. 17322 before this Court. The G. C. M. flies in the face of the statute which provides that assets are capital assets and remain as such *whether or not connected with the taxpayer's trade or business.*

B. Petitioner's commodity futures transactions do not fall within the so-called "Hedging Exception to Section 117".

Respondent has admitted repeatedly in his brief (pages 34, 38) that petitioner was not engaged in *true hedging* operations. Nevertheless, respondent states that this makes no difference (Brief, page 38). Petitioner wishes to emphasize the blatant inconsistency of respondent's position in this case from its prior position in all other cases. (See page 15, footnote 2).

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[3] See *Rich & Rippe, "Tax Aspects of Commodity Futures Transactions with a Business Purpose"*, 2 Tax Law Review 541 at 559, where the authors recognized the conflict between the statute and the concept.

1. Respondent Took an Inconsistent Position in Prior Cases

In *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F. (2d) 772 (5th Cir., 1941) the Court held that the taxpayer's losses did not result from *true hedging* operations and limited the taxpayer to capital loss treatment. Thereupon the taxpayer filed a petition for certiorari (*Farmers & Ginners Cotton Oil Co.* v. *Commissioner*, 314 U. S. 683 (1941)). The Commissioner made the following argument to this Court in successfully resisting taxpayer's application for certiorari. We quote from page 7 of his brief in that case:

> "2. Section 117(b) makes no exception for hedging transactions nor has any exception been made therefor by Treasury Regulations. However, it has been the practice to permit deductions in full upon losses from *true hedging* transactions. The theory is that hedging is a form of insurance of normal business profits against the risk of fluctuations in the market price of the product in which the taxpayer deals or in the market price of the materials which are used by him to make that product. But this case does not present a *true hedging* transaction." (Emphasis supplied.).

This statement repeated the argument previously made by respondent in his brief in the Court of Appeals below in the same case at pages 10 and 11 as follows:

> "It (the taxpayer) was merely assuming an-

other new and different risk, and it thus becomes a speculator and not a hedger in the refined cottonseed oil futures market. The taxpayer was endeavoring to recover or recoup a loss from a risk which it had assumed but not protected itself against by hedging. That was not hedging or insuring against a loss and the reason for permitting the deduction in full of losses from hedging did not exist."

Nor was this a mere transitory position taken by the Commissioner. In *Trenton Cotton Oil Co. v. Commissioner*, 147 F. (2d) 33 (6th Cir., 1945), rehearing denied, 148 F. (2d) 208 (6th Cir., 1945), respondent made the following argument in his answering brief in that case at page 8:

"If the losses are *true hedging losses*, they are considered to be deductible in full as ordinary and necessary business expenses under Treasury practice, but if the losses are from speculative transactions, they are losses from sales of capital assets and may be deducted only to the extent of $2,000 plus gains from such sales under Section 117(d) * * *." (Emphasis supplied.)

At page 9 of the same brief:

"There can be no question that the futures contracts are the type of property embraced by the definition of 'capital assets' in Section 117(a)(1) of the Revenue Act of 1938 * * *."

Again at page 10 of the same brief:

> "The contracts to buy and sell refined cottonseed oil for future delivery were property held by the taxpayer and not one of the four types of property expressly excluded by the statute from the definition of capital assets. Consequently, unless the dealings in the contracts are *true hedges,* the futures contracts are capital assets. *Commissioner* v. *Farmers & Ginners Cotton Oil Co.,* 120 F. (2d) 772, (C. C. A. 5th), certiorari denied, 314 U. S. 683; *Commissioner* v. *Covington,* 120 F. (2d) 768 (C. C. A. 5th), certiorari denied, 315 U. S. 822; *Commissioner* v. *Bamfield,* 122 F. (2d) 1017 (C. C. A. 9th). See also *Farmers & Ginners Cotton Oil Co.* v. *Commissioner,* decided March 3, 1942 (1942 P-H B. T. A. Memorandum Decisions, par. 42,120) affirmed 130 F. (2d) 941 (C. C. A. 5th) on authority of former opinion reported at 120 F. (2d) 772; *Tennessee Egg Co.* v. *Commissioner,* 47 B. T. A. 558." (Emphasis supplied.)

Respondent is now taking the reverse position that the existence or nonexistence of a *true hedge* is of no consequence whatever (Brief 38). Respondent argues that because petitioner protected itself against a rise in corn prices it should be treated as if it were hedging, denominating such action as "partial insurance" (Brief 35).

2. Petitioner Merely Shifted the Risk of Loss

All petitioner did by buying corn futures contracts was to exchange protection from the risk that the price of raw corn would decline for protection against the opposite risk that the price of raw corn would rise. Respondent has recognized this in his brief at page 14 in the statement of facts. If any taxpayer buys any property at any time, it shifts from a risk that the property will rise in price, to a risk that the property will decline in price. This is not hedging in any respect; it is not insurance; it merely is an exchange of risks. By the very same token if petitioner had never purchased a corn future, by doing absolutely nothing, it would have protected itself against the risk that the price of corn would decline. It would not have protected itself against the risk that the price of corn would rise. To designate such inaction as in the nature of a hedge because petitioner would be protected against a decline in the price of corn but not a rise in the price, spotlights the poor logic of the respondent's position. This is not "insurance" in any sense of the word.

Respondent, at page 35 of his brief, has stated that the "principal risk" against which petitioner sought to protect itself was that the price of corn would rise. The record will not substantiate that there was a principal risk. The stipulation of facts (R. 221) shows the gains and losses for all years from 1932 through 1942, inclusive. The figures show that there

were net gains in five different years totalling $1,535,282.97 and net losses in six years totalling $1,546,795.51. This demonstrates that the risk was substantial in either direction.

3. Respondent's Two Charts Are Misleading

a. Chart No. 1

Chart No. 1 is an adaption of the chart appearing in petitioner's initial brief which respondent says is misleading. Respondent has taken petitioner's chart (Brief, page 9), which was prepared from statistical information in the record, and so rearranged it as to confuse rather than to clarify the basic facts in this case.

Respondent has attempted to match corn futures owned against orders on hand to show their broad relationship to one another, completely disregarding the fact that petitioner had sufficient raw corn and finished stocks on hand to offset its orders except for minor amounts at April 1, 1940, July 1, 1941, October 1, 1942 and December 24, 1942. The record discloses that petitioner had 2,303,000 bushels of storage capacity for its raw corn at all times pertinent (R. 33). While there is nothing in the record directly on this point it is inconceivable that petitioner's plants at any time had no products in process of manufacture during the years in question (the contrary is demonstrable from the Tax Return (Joint Exhibit 12-H, R. 78, 116)).

Petitioner in computing the quantity of available inventory on hand to fill orders had three sources to look to, not merely to its stocks of finished goods as argued by respondent, *i. e.* raw corn, goods in process, and finished stocks. Petitioner's chart, prepared on a cumulative basis, thus demonstrates the true situation (Brief 9).

Respondent has therefore drawn an erroneous conclusion that there was "a broad relationship between taxpayer's holdings of futures and its orders on hand" (Brief 37).

b. Chart No. 2

Commissioner's Chart No. 2 is an attempt to make an inverse correlation between petitioner's futures position and commercial corn carry-overs at terminal markets to prove petitioner reduced its futures position as the corn carry-over increased. The chart in point of fact proves nothing and tends to confuse. It should be noted that the total carry-over in all terminal markets in the United States in 1941 was only 40,000,000 bushels and slightly less in 1942 as shown on Commissioner's Chart No. 2. The stipulated facts (Exhibit 2-B, R. 224, 231) show how insignificant this carry-over was. Petitioner alone, one consumer of raw corn among many thousands, used over 54,000,000 bushels of corn in 1941 and over 60,000,000 bushels of corn in 1942. This was more than the total national carry-over in each year. In other words, petitioner

alone could have consumed the entire corn carry-over if it were available.

The insignificance of the carry-over is further demonstrated by the following figures taken from the United States Statistical abstract, 1949 Edition, page 668, which shows: that the total corn crop in 1941 was 2,651,000,000 bushels, and in 1942 was 3,068,000,000 bushels. The carry-over was a mere one and a half percent of the corn crop in 1941 and less in 1942. In any event the degree of inverse correlation is a pure coincidence. The record shows that the reduction in petitioner's corn futures position starting in 1940 was the result of the outbreak of war (R. 54).

4. The Commodity Exchange Authority Has Held Petitioner Was Not Hedging

Respondent points out, page 41 of his brief, that in the 1952 Commodity Exchange Authority proceeding, petitioner stated it was able to forecast what its sales would be for months ahead. There is nothing in the present record to indicate that forecasts of sales were made in the period from 1936 to 1942. As a matter of fact this forecasting technique was developed subsequent to World War II.

Most significantly, the Secretary of Agriculture held in that proceeding that even though petitioner was able to forecast its sales and even though petitioner was balancing its purchases of corn futures contracts with short sales of cane sugar futures contracts, *it still*

was not hedging. It is an "*a fortiori*" conclusion that if petitioner was not hedging in 1952 even with these additional elements, it could not have been hedging in the years here involved when such elements were not present.

The Government urges in its brief in the appeal from the Commodity Exchange Authority holding (now pending before the Court of Appeals for the 2nd Circuit) at page 21 thereof:

> "There is no existing fixed price obligation in the cash market which would afford the basis for a purchase of futures contracts as a hedge. This is obvious with respect to the petitioner's anticipated manufacturing requirements and expected sales, and is equally apparent with respect to the petitioner's contracts to sell at a price to be determined later."

Again at page 37 of its brief on that appeal the Government argues:

> "Hence the petitioner's attempt to demonstrate that a hedge consists of a purchase of futures contracts to offset some transaction that is *expected to occur* at a later date is *squarely contrary to the fundamental principles of hedging.*" (Emphasis supplied.)

It therefore follows that the forecasts of sales which petitioner was able to make in 1952 would not alter the fact that petitioner was not hedging and could not hedge.

5. Taxpayers' Intent Is of No Significance

Respondent alludes (Br. 39) to the testimony of the witness Hall as to the intent of the taxpayer in entering into commodity futures transactions (R. 72, 73, 76). The cases cited at Footnote 2, page 15 of this brief, are amply clear that the *purpose or intent* of a taxpayer will not govern in determining whether a commodity futures transaction is to be treated as a capital asset transaction or as an ordinary one. In each case, the taxpayer intended to hedge and thought he was hedging. The courts' decisions, nevertheless, ignored intent. The courts based their findings solely on the facts as developed, i. e., whether or not the taxpayers were engaged in "*true hedging*" operations. If not, even though the taxpayers actually thought they were hedging, the transactions were treated as capital losses. *Estate of Dorothy Makraunsky*, 5 T. C. 397 (1945) affirmed 154 F. (2d) 59 (3rd Cir., 1946); see also *Tennessee Egg Co.*, 47 B. T. A. 558 (1942).

It is also a matter of no importance that the taxpayer treated the transactions originally as part of cost of goods sold. When the Commissioner in 1940 proceeded to urge the theory of *true hedging* as the controlling factor and won the series of cases previously cited at page 22 of petitioner's initial brief, this taxpayer was compelled to reconsider its position and to conform it with the law as it then understood it. Furthermore, with the sole exception of this

present proceeding, The Tax Court and the other lower courts have adhered consistently to the test of *true hedging*. Even as recently as *Fulton Bag & Cotton Mills;* 22 T. C. 1044 (1954), which was subsequent to its decision in the instant case, The Tax Court reaffirmed that test.

Petitioner's chart (initial brief, page 9) and Commissioner's Chart No. 1 both show that at the precise time when petitioner had the largest amount of orders on hand, it had the least amount of corn futures contracts (July 1, 1941). However, in the period from July 1, 1938 through July 1, 1939 when it had the smallest amount of orders on hand it had the largest amount of futures contracts. This is an inverse correlation and demonstrates that petitioner's futures contracts position did not relate to nor tie in with its customers' orders.

6. Petitioner—the Legitimate Capitalist

Respondent belittles petitioner's contention that it falls within the category of a "legitimate capitalist" in spite of the fact that this Court in *United States* v. *New York Coffee & Sugar Exchange, Inc.*, 263 U. S. 611 (1924), pointed out that persons dealing in futures must be classified in not two, but three separate classes:

1. "Those who use them to hedge";
2. "Legitimate capitalists who, exercising their judgment as to the conditions, purchase or sell

for future delivery with a view to profit based on the law of supply and demand";

3. "Gamblers or irresponsible speculators who buy or sell as upon the turn of a card."

Petitioner's commodity futures position during the years here in question represented the exercise of judgment by its officers that the interests of the company would best be protected by maintaining a long position in the event that a repetition of the terrible droughts of 1934 and 1936 might recur (R. 51 and 52).

Petitioner was in the same position as a manufacturer of wood products who, realizing that timber might become scarce, buys an area of timberland with the intention of using it in production if the scarcity of lumber develops. Later it sells that land and timber, finding that it has sufficient lumber from its normal sources to cover its requirements. Would respondent say that because the timber might have been used by the manufacturer as part of its raw material, he should exclude it from the category of capital assets, just as he now contends in the case of unneeded corn futures? In the present case, when petitioner took delivery of corn upon the maturity of a corn futures contract it included the cost in inventory and subsequently it became a part of the cost of goods sold (R. 80). When petitioner did not require the corn, it disposed of the contract in the same manner that the manufacturer disposed of the unneeded timberland.

7. Conclusion

The phrase adopted by The Tax Court as decisive in this case, to wit, "an integral part of its manufacturing business" finds no support in Section 117(a) which specifically defines capital assets whether or not used in the taxpayer's business. As is indicated herein above and in petitioner's original brief, it is believed that if this Court sustains respondent's theories and those of the Courts below on this point, great uncertainty in the administration and application of the capital limitations provision will follow. In addition it will result in a substantial reduction to the revenue.

The uncertainty will stem directly from the question of what degree of proximate relationship with the taxpayer's trade or business is required to characterize an asset for tax purposes as ordinary rather than capital. Congress certainly was aware of this problem when it originally enacted and later revised the statute. For had it not considered this problem, the history of these provisions would not have developed as it has. Most assets of proprietorships and partnerships and all those of business corporations have some relationship to the business conducted by such entities. If respondent is sustained all losses whether capital or otherwise will be claimed as ordinary deductions by such entities and the litigation and confusion resulting therefrom will be enormous.

That a very considerable number of capital losses will be allowed as ordinary deductions seems indisputable, for the impossibility of respondent's policing such an imprecise test as the proximate relationship of any given asset to the trade or business in question cannot be doubted. It might be argued that Congress could remedy such a result by some specific legislation, but that view itself does not bear close inspection for the test already in the statute is precision itself.

II

Commodity futures transactions are subject to the wash sales provisions of Section 118 of the Internal Revenue Code.

A. The futures contracts purchased and sold were substantially identical.

Petitioner and respondent are both in agreement that the purpose of Section 118 was to prevent the taking of a "paper loss" in order to acquire a tax advantage where the taxpayer did not truly alter his economic position (Respondent's Brief, page 48). Petitioner and respondent are also in agreement that corn futures contracts mature in different months within any given year.

The point of difference between petitioner and respondent lies in the fact that petitioner claims and respondent denies that a corn futures contract requir-

ing May delivery is "substantially identical" to a corn futures contract requiring July delivery, and that a July delivery is "substantially identical" to a September delivery.

The statistics supplied by respondent himself at page 50 of his brief show that on January 2nd, 1942, the high of the May delivery prices differed from the low of the July delivery prices by less than one cent. They further show that the high of July differed from the September low of the same year by only ¼ cent. Respondent makes the error of insisting not on *substantial identity* as provided in Section 118, but on *absolute identity*. Petitioner in moving its position forward from one futures contract to the next is not changing or altering its economic position. It is merely continuing it. This is the precise situation to which Section 118 was directed.

It is true that in the year of a drought or in the year following a drought prices of commodities bearing maturities within a twelve-month period will vary, but these are the exceptional situations. The proof in this case is that the futures contracts purchased by petitioner were *substantially identical* to those sold (R. 90), and respondent's statistical information for the year 1942 (Brief, page 50) bears this out. Thus, between November 2nd and December 1st, 1942 the statistics show that December futures rose five and a fraction cents; so did May futures and so did July futures. This establishes "substantial identity".

B. Futures contracts are securities within the meaning of the term as used in Section 118.

Petitioner relies on the decision of the Court of Appeals for the 6th Circuit in *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. (2d) 33 (6th Cir., 1945). Respondent, on the other hand, while admitting (Br. 48) that the purpose of Section 118 is to close the "paper loss" loophole, would only close the loophole in the case of stocks and bonds, leaving it wide open where commodity futures are involved. Was the intent of Congress only to close the loophole partially and *lose revenue* thereby? Respondent does not deny that commodity futures trading on regulated exchanges is as extensive as trading in securities; nor does respondent deny that the same broker can execute both types of transactions on the same floor of the Chicago Board of Trade (R. 94).

Respondent urges that because commodity futures contracts mature within eleven months, the evil of paper losses does not exist (Brief, page 55). Respondent has failed to consider that a short-term loss in stocks, where the security is held for less than six months, can result in a "wash sale" in the same manner and with identical effect as in the case of long-term securities. In both cases the loss is disallowed under Section 118. The period for which the speculator may hold the stock, the bond, or the commodity futures contract is immaterial. He can have a paper

loss within days, weeks or months, as well as within years. There is nothing in the statute to indicate that the evil Congress sought to correct only involves the long-term investor, as respondent contends (Brief, page 55).

Respondent, at page 51, *et seq.*, has cited Section 4(c) of the Commodity Exchange Act which forbids wash sales, cross sales, accommodation trades and fictitious sales. The term "wash sale" as used in that statute is not the same "wash sale" referred to in Section 118. It is, as the statute points out, commonly known to the trade as a *fictitious* sale, whereas a wash sale in tax parlance is a *real* sale. A "wash sale" under Section 118 occurs where a taxpayer acquires the same long position within thirty days before or after a sale at a loss. If the sale results in a gain, the gain is recognized and taxed. *Valley Waste Mills* v. *Page*, 115 F. (2d) 466 (5th Cir., 1940), certiorari denied, 312 U. S. 681 (1941); *Harriss* v. *Commissioner*, 143 F. (2d) 279 (2nd Cir., 1944). The Commodity Exchange Act definition is, therefore, not controlling on this point, since the two statutes deal with diverse transactions.

In conclusion, petitioner submits that the same evil exists in the allowance of "paper losses" from transactions in stocks, bonds and commodity futures contracts, all of which are sold on regulated exchanges on margin. It is this evil that the Court recognized

in *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. (2d) 33 (6th Cir., 1945), affirming T. C. Memo. Op. (Dec. 28, 1943), as the evil which Congress sought to correct.

CONCLUSION

It is urged that for the foregoing reasons the judgment of the Court below should be reversed.

Respectfully submitted,

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Dated: October 14, 1955

APPENDIX A

SEC. 1221. CAPITAL ASSET DEFINED. (Internal Revenue Code of 1954.)

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, or similar property, held by—

(A) a taxpayer whose personal efforts created such property, or

(B) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property;

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1); or

(5) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

AUG 1955
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954.

No. [redacted] 20

CORN PRODUCTS REFINING COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

(Consolidated Proceedings.)

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. 457

CORN PRODUCTS REFINING COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

(Consolidated Proceedings.)

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Court of Appeals (R. 293) is reported at 215 F. (2d) 513.

The opinion of The Tax Court for the year 1940 appears in 16 T.C. 395 (R. 22). The opinion of The Tax Court for the year 1942 was a memorandum decision, dated June 30, 1952 (R. 201).

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on August 25, 1954 (R. 301). A Petition for Rehearing was denied by that Court on the 27th day of September, 1954. The Petition for a Writ of Certiorari was filed on the 9th day of November, 1954, and was granted on January 10, 1955. The jurisdiction of this Court rests on 28 U. S. Code 1254(1).

STATUTES INVOLVED

The statutory provisions involved are as follows:

With respect to Question I, Section 117 of the Internal Revenue Code of 1939;

With respect to Question II, Section 118 of the Internal Revenue Code of 1939.

These provisions are printed in Appendix A, *infra*, pages 53 through 68.

QUESTIONS PRESENTED

Two questions are presented for the review of this Court in accordance with its order granting the Petition for Certiorari:

I

Commodity Futures Transactions

Are transactions in commodity futures, which are not "true hedges", capital asset transactions and thus subject to the provisions of Section 117 of the Internal Revenue Code of 1939, or do such transactions give rise to ordinary income and ordinary deductions?

II

Wash Sales

Are commodity futures "securities" within the meaning of Section 118 of the Internal Revenue Code of 1939 and thus subject to the "wash sales" provisions thereof?

The answers to Question I and Question II will affect, for the years 1940 and 1942, the amount of Petitioner's excess profits credit (based on income), its net income and its income and excess profits taxes.

The consequences are such under the excess profits tax law in the computation of the excess profits credit that Respondent is taking a position diametrically opposed to the position he would ordinarily take for normal income tax purposes. This inversion can be readily seen from the fact that:

(a) Respondent is contending on Question I that where there are losses on commodity futures transactions, the losses are ordinary losses and deductible without limitation; and

(b) Respondent is contending on Question II for a *limitation* of the scope of the "wash sales" provision of the Internal Revenue Code.

Petitioner, on the other hand, is taking the contrary position in its own interest, which happens to be clearly in the interest of the greater public revenue.

STATEMENT

The facts with respect to the issues are as follows:

I

Commodity Futures Transactions

The Petitioner, Corn Products Refining Company, is a nationally-known manufacturer of products made from corn. Its average annual grind or consumption of raw corn was in excess of 35,000,000 bushels in the years 1937 through 1940 and up to over 60,000,000 bushels in 1942 (Exhibit 2-B, R. 224, 231).

Petitioner's major products were corn starch, corn syrup, and corn sugar. By-products, which were substantial contributors to Petitioner's income, were corn feed and corn oil (R. 22, 65). All of its products competed extensively with products made from other raw materials. Most importantly, for the instant case, Petitioner's refined corn sugar, cerelose, competed with cane and beet sugar.

In 1934 and 1936, severe droughts occurred in the Mid-West corn belt, and the price of corn rose sharply. As a result, Petitioner found it impossible to compete profitably with cane and beet sugar in the

sales of its corn sugar, and "lost money on each sale" (R. 51).

In an attempt to meet this condition, Petitioner in 1937 evolved a program whereby it would buy corn futures whenever it considered the price of corn low, and would gradually establish a substantial long futures position in the neighborhood of 12,000,000 bushels (R. 50, 52). The idea was to build this position during the year until it could be ascertained with some degree of certainty that no drought was likely to occur, and, if that were the likelihood, the long position would then be liquidated in part, usually in July, when crop conditions could be reasonably forecast.

The program was never put into full operation although substantial quantities of corn futures were acquired. In 1939, the outbreak of the European War made this plan unnecessary because of the attendant rise of the price of cane and beet sugar (R. 52, 156).

Petitioner's corn futures were acquired and disposed of, with minor exceptions, through brokers on regulated exchanges (R. 32). They were not sold to customers in the ordinary course of its business (R. 32). They were not included in inventory (R. 81). They were not subject to depreciation (R. 33).

The policy of the Petitioner was to sell for shipment within thirty days (R. 67) against "stocks of

finished goods" and storage corn (R. 60). The purpose and effect of this policy can be seen from chart at page 9, the factual material for which comes from R. 33 and 224 and Exhibits 6F (R. 49, 95-97) and 7G (R. 49, 101) for the year 1940, 6F (R. 246, 267, 268) and 7G (R. 247, 270) for 1942.

Mr. Praeger, Petitioner's General Purchasing Agent, testified that Petitioner's storage capacity was 2,300,000 bushels (R. 50). As to purchases of greater quantities, it was cheaper to purchase futures than corn since storage charges would have to be paid.

Mr. Praeger testified that the purpose of the purchase of futures was to accumulate a "long" position of approximately 12,000,000 bushels (R. 52). By definition, this meant corn, stocks and futures in excess of orders (R. 60). Since the orders were nearby (thirty days in general), they were first applied against corn and stocks (R. 60). The statistical summary on page 8 and the chart at page 9 shows that the amount of orders which could at any time have been applied to offset futures was insignificant. In general, the futures matured well after orders on hand. Exhibit 3C (R. 33, 37).

STATISTICAL SUMMARY OF CHART

Orders and Stocks from Exhibits 6-F, 1940 (R. 49, 95-97); 1942 (R. 246, 267-269)
Stocks from Exhibits 7-G, 1940 (R. 49, 101); 1942 (R. 247, 271)
Storage Capacity: 1940 (R. 33); 1942 (R. 224)

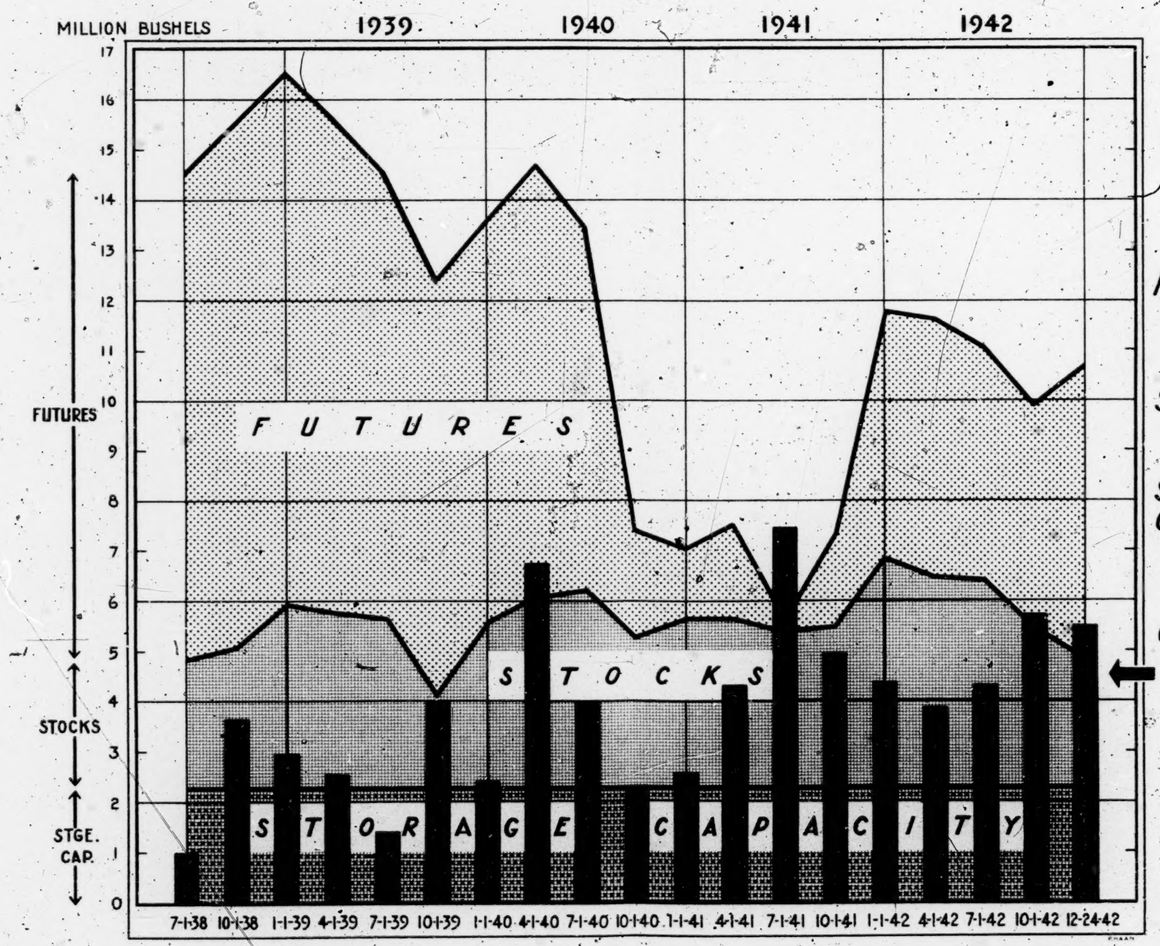
Thousands of Bushels

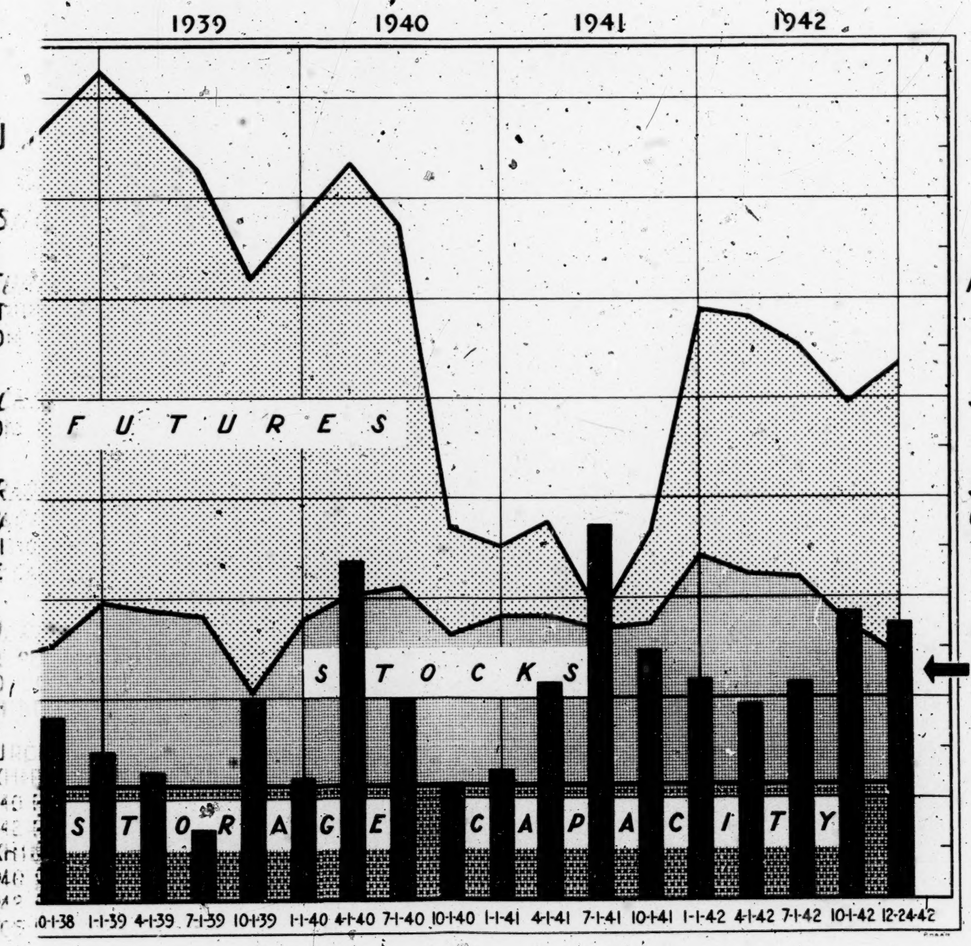
	7/1/38	10/1/38	1/1/39	4/1/39	7/1/39
Orders	985	3635	2950	2550	1405
Futures	9700	10450	10600	9800	8850
Stocks	2565	2820	3655	3505	3420
Storage Capacity	2303	2303	2303	2303	2303

	10/1/39	1/1/40	4/1/40	7/1/40	10/1/40
Orders	4010	2420	6770	4015	2225
Futures	8250	8050	8650	7200	2100
Stocks	1890	3270	3800	3965	3000
Storage Capacity	2303	2303	2303	2303	2303

	1/1/41	4/1/41	7/1/41	10/1/41	1/1/42
Orders	2550	4280	7470	4950	4350
Futures	1400	1900	300	1850	4950
Stocks	3330	3340	3070	3210	4560
Storage Capacity	2303	2303	2303	2303	2303

	4/1/42	7/1/42	10/1/42	12/24/42
Orders	3830	4315	5694	5495
Futures	5120	4650	4450	5850
Stocks	4220	4160	3178	2534
Storage Capacity	2303	2303	2303	2303





CUMULATIVE CHART SHOWING:

FUTURES - CORN FUTURES OWNED FROM EXHIBIT 7-G

STOCKS - INVENTORY FROM EXHIBIT 6-F

STORAGE CAPACITY - PETITIONER'S STORAGE CAPACITY

ORDERS - ORDERS FOR PETITIONER'S PRODUCTS FROM EXHIBITS 6-F & 7-G

SOURCE:
EXHIBIT 6-F
1940 R.49, 95-97
1942 R.246, 267-269
EXHIBIT 7-G
1940 R.49, 101
1942 R. 247, 271
STGE. CAP.. R.33, 224

Orders were evidenced by a form of contract (Ex. 10, R. 67, 105). The price was named, but provision was made that if the price in effect on the day of delivery were lower, the buyer by contract was to have the advantage of such lower price (Ex. 10, R. 67, 105, 203).

Petitioner also had the policy of permitting its customers to cancel their orders in their discretion (R. 203). Cancellations were frequent, unpredictable, and at times substantial (R. 69).

Petitioner was not protected against contract cancellations and price declines which the expert witness Henry said made a true hedge impossible (R. 67, 91, and 92) (Ex. 7G, R. 49, 91).

II

Wash Sales

A corn future dealt with on a regulated exchange (only such are involved in this case) consists of a document or instrument evidencing a right to buy 5,000 bushels of corn, or some multiple thereof, of a stated quality, at a stated price, upon delivery during a stated month in the future (R. 89, 90, 92). All such futures mature within eleven months. Months of maturity of such instruments are May, July, December, and, occasionally, March and October (R. 54, 204), although this Petitioner sold most futures prior to maturity and bought others to replace or extend them.

There is no difference between one corn future and another except as to date of maturity and obligor (R. 90). The seller or purchaser, as the case may be, is not known to the other party buying or selling and, consequently, their identities are of no economic significance. They are dealt with on regulated exchanges, such as the Chicago Board of Trade (R. 89, 90, 91). They are purchased and sold through brokers (R. 89, 90). Each future is evidenced by a writing (Ex. 14, R. 89, 151). Futures are dealt in on margin (R. 94).

Stocks, bonds, and commodity futures are all listed and traded on the Chicago Board of Trade (R. 94). As far as a floor broker is concerned, there is no essential difference between trading in stocks and bonds on margin and trading in futures on margin since all are negotiable (R. 94).

SUMMARY OF ARGUMENT

1. Corn futures contracts are capital assets. They fall expressly within the definition of capital assets in Section 117(a) of the Internal Revenue Code of 1939. None of the exclusions in that section applies to them. Any gain or loss resulting from their sale or exchange should be treated as capital gain or capital loss as provided in Section 117. In any event, Petitioner's transactions in corn futures were not "true" hedges and therefore do not come within the so-called hedging exception to Section 117.

2. Corn futures traded on regulated exchanges are "stocks or other securities" as that term is used in Section 118 of the Internal Revenue Code of 1939 and are subject to the "wash sales" provision of such section.

ARGUMENT

I

Petitioner's Commodity Futures Transactions were Capital Asset Transactions under the Internal Revenue Code of 1939.

The question of the proper tax treatment of commodity futures transactions is one of first impression for decision by the Supreme Court of the United States. This Court has considered the nature of commodity futures trading, but not its tax consequences in *United States* v. *New York Coffee & Sugar Exchange, Inc.*, 263 U. S. 611 (1924) and *Chicago Board of Trade* v. *Christie Grain and Stock Company*, 198 U. S. 236 (1904). The tax consequences of commodity futures transactions have received considerable attention in the lower courts and were once presented to this Court on a petition for certiorari in *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F. (2d) 772, certiorari denied, 314 U. S. 683 (1941).

Petitioner contends that its transactions in commodity futures gave rise to capital gains and losses, not to ordinary gains and losses.

A. Section 117 of the Internal Revenue Code Governs Petitioner's Commodity Transactions.

The comprehensive provisions of Section 117 of the Internal Revenue Code of 1939, in effect during the tax years 1940 and 1942, which are pertinent here, set forth the treatment to be accorded to the results of taxable sales and exchanges of "capital assets". A reading of the section (Appendix A, pp. 53 to 58) will convince that, taken as a whole, it provides a specific, integrated, coherent and total scheme for the treatment of such sales or exchanges.

Section 117(a), insofar as it is relevant here, defines the term "capital assets" as follows:

> "(1) *Capital Assets.*—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l); * * * "

Under this statutory definition all types of property are "capital assets" unless they fall within a spe-

cific exclusion set forth in the definition. This is recognized by the Commissioner's Regulations (Regulations 103, Section 19.117-1) which state:

> "The term 'capital assets' includes all classes of property not specifically excluded by section 117(a)(1)."

It is clear that Petitioner's corn futures are "capital assets" under the statutory definition. They are property. They do not come within any of the specific exclusions set forth in the section in that:

(1) They are not "stock in trade of the taxpayer".

(2) They are not "other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year".

(3) They are not "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business".

(4) They are not "property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23(l)".

It is clear that Section 117 includes Petitioner's commodity futures transactions. The Section specifically includes within its purview *all sales and exchanges* of "capital assets" except those non-taxable reorganization exchanges expressly exempted therefrom by Congress in Section 112—none of the provisions of which is relevant here.

Where Congress has addressed itself so specifically, so unambiguously, and so comprehensively to the problem of "capital assets", as it has in Section 117, the question of the tax treatment of Petitioner's commodity futures, which are clearly "capital assets" within the meaning of the section, should be referred to that section and to the plain meaning of the words of that section alone. Accordingly, Petitioner's commodity futures transactions should be treated for tax purposes as capital asset transactions.

B. Petitioner's Commodity Futures Transactions Do Not Fall Within the So-called "Hedging Exception" to Section 117.

(1) Development of the "Hedging Exception"

Before the passage of the Revenue Act of 1934, the statutory definition of a capital asset excluded any property held for less than two years. Since commodity futures transactions were always required to be closed out in a shorter period than two years under the rules of the various commodity exchanges, no question of their tax treatment as capital assets arose.

The Revenue Act of 1934, however, effected a major change in the definition of capital assets. It completely abolished the time element as a basis of distinction between capital and non-capital assets, and set forth a new definition of capital assets which was essentially the same as that quoted above (p. 13). Commodity futures fell literally and precisely within this statutory definition of capital assets.

Thereupon, the Treasury Department in 1936 issued General Counsel's Memorandum No. 17322 (XV-2 C. B. 151).

This G. C. M. divided all commodity futures transactions (cotton was the commodity specifically involved) into two types, *speculative* and *hedging*, and expressed the opinion that "hedging transactions are essentially to be regarded as insurance rather than a dealing in capital assets" although the "provisions pertaining to capital gains and losses govern gains or losses on futures contracts which are speculative." It stated (p. 152):

> "Such hedges, which eliminate speculative risks due to fluctuations in the market price of cotton and thereby tend to assure ordinary operating profits, are common trade practices and are generally regarded as a form of insurance (the only kind available as protection against such risks) necessary to conservative business operation. Where futures contracts are entered into only to insure against the above-mentioned risks inherent in the taxpayer's business, the hedging operations should be recognized as a legitimate form of business insurance. As such, the cost thereof (which includes losses sustained therein) is an ordinary and necessary expense deductible under section 23(a) of the Revenue Act of 1934 and corresponding provisions of prior Revenue Acts."

And so the concept of hedging was imported into the problem of the tax treatment of the results of the

purchase and sale of commodity futures, a problem for which Congress had provided a clear and complete set of rules to deal with in Section 117—and this without reference to "hedging".

It cannot be said that Congress was unaware of hedging transactions and their impact taxwise. In Section 502(c) of 1939 I. R. C. Congress made a specific exception for hedging transactions in its definition of personal holding company income. Yet, while Congress has from time to time amended Section 117(a) to provide additional exclusions to the definition of "capital assets", it has never made "hedging" an exclusion.[1]

Following the G. C. M. a number of cases were decided wherein the concept of hedging as an exception to Section 117 was applied to the question of the proper tax treatment of the results of purchases and sales of commodity futures.[2]

In all of these cases where the courts found that a hedge existed, they treated the taxpayer's gains and

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[1] By Section 210(c) of 1950 I. R. C., Congress amended Section 117(a) to exclude copyrights, literary, musical and artistic compositions under specific circumstances. In 1954 I. R. C., Congress added a further exclusion in Section 1221, successor to Section 117(a), with respect to accounts or notes receivable acquired in the ordinary course of trade or business. In addition, when Congress in the Revenue Act of 1942 saw fit to make a qualified exclusion out of real property used in a taxpayer's trade or business, in a most intricate bit of lawmaking it amended Section 117(a) to make this sort of property an exclusion and added Section 117(j) to set limitations and conditions on the exclusion.

[2] See cases cited at page 22.

losses as ordinary; where they found that a hedge did not exist, they treated the taxpayer's gains and losses as capital.

In none of these cases was the question of the validity of hedging as an exception to Section 117 raised. This is understandable in view of the fact that in all these cases the taxpayers were seeking to take advantage of the G. C. M. so as to be able to *deduct losses in full* on their commodity futures transactions. The Commissioner of Internal Revenue on the other hand apparently considered himself bound by the G. C. M.

In any event, this Court has never decided the question of the validity of the so-called "hedging exception" to Section 117, but Petitioner in the instant case squarely raises the question and seeks a decision on the point.

(2) Petitioner's Commodity Futures Transactions Were Not Hedges

(a) *The Definition of a Hedge Generally*

There are many meanings of the term "hedge" in common usage.[3] The United States Secretary of Agriculture who exercises jurisdiction over Com-

[3] Webster's Dictionary contains some fifteen definitions. Quite commonly, one hears — "He is buying common stock as a hedge against inflation" or "How did he answer the question? He hedged."

modity Exchanges has recently stated in one of his decisions[4] that

> "* * * the hedge is used to insure processors against loss *due to price changes in commodities.* Its purpose is to insure processing profit. Its object is not to return a speculative profit, for the reason that any profit derived on the futures merely equalizes or offsets a loss which has been incurred on a transaction or market position in the cash commodity market. The cash market transaction and the exchange transaction are complementary. By means of the futures trading, the hedger passes on to others a market risk, that is, the risk of price change in the commodity. Accordingly, *an essential characteristic of true hedging is a price commitment with respect to the cash commodity or product which is protected by a futures transaction.* In other words, a futures sale is a hedge to the extent that the trader owns or purchases an equivalent amount of the cash commodity or products or by-products thereof and *a futures purchase is a hedge to the extent that the trader has contracts for forward sales of the cash commodity or products or by-products of the commodity at fixed prices.*" (Emphasis supplied in part.)

This Court has on occasion defined the term "hedging". In *Chicago Board of Trade* v. *Christie*

[4] *In re Corn Products Refining Company*, 13 Agric. Dec. 1117, at p. 1130 (1954).

Grain and Stock Company, 198 U. S. 236 (1904), this Court said (p. 249):

> "Hedging, * * *, as it is called, is a means by which collectors and exporters of grain or other products, and manufacturers who make contracts in advance for the sale of their goods, secure themselves against the fluctuations of the market by counter contracts for the purchase or sale, as the case may be, of an equal quantity of the product, or of the material of manufacture."

In *Brown* v. *Thorn,* 260 U. S. 137 (1922), this Court said (pp. 139, 140):

> "* * * hedging being explained as a means by which manufacturers and others who have to make contracts of purchase or sale in advance secure themselves against the fluctuations of the market by counter contracts."

In *United States* v. *New York Coffee & Sugar Exchange, Inc.,* 263 U. S. 611 (1924), this Court defined hedging as insurance against loss by unfavorable changes in price at the time of actual delivery of what is sold or bought in a business.

Incidentally, in the last case, this Court classified persons who engage in commodity futures transactions in three categories, as follows (p. 619):

> "Those who deal in 'futures' are divided into three classes: First, those who use them to hedge,

i. e., to insure themselves against loss by unfavorable changes in price at the time of actual delivery of what they have to sell or buy in their business; second, legitimate capitalists, who exercising their judgment as to the conditions, purchase or sell for future delivery with a view to profit based on the law of supply and demand; and, third, gamblers, or irresponsible speculators, who buy or sell as upon the turn of a card."

It will be remembered that G. C. M. 17322 mentioned only two classes of persons who engage in commodity futures transactions, to wit, "hedgers" and "speculators". It is Petitioner's contention that it was in the "legitimate capitalist" class described by this Court, the very class which the G. C. M. fails to mention at all.

None of the foregoing definitions of hedging was enunciated in connection with a tax case.

(b) *The Definition of Hedging in Tax Cases. The Criterion of the "True Hedge".*

Following the principle set forth in G. C. M. 17322, the courts, in defining a hedge for the tax purpose of determining whether or not commodity futures transactions were capital transactions, at an early date settled on the concept of the "true hedge" as the criterion. This criterion has been scrupulously applied until the instant case.

The principal cases and the findings therein were:

Name and Citation	Finding
Ben Grote, 41 B. T. A. 247 (1940).	"Hedge": ordinary loss allowed.
Commissioner v. *Farmers & Ginners Cotton Oil Co.,* 120 F. (2d) 772 (5th Cir. 1941), cert. denied, 314 U. S. 683 (1941).	No "true hedge": capital loss.
Kenneth S. Battelle, 47 B. T. A. 117 (1942).	"Hedge": ordinary loss allowed. Also no "hedge": capital loss.
Tennessee Egg Co., 47 B. T. A. 558 (1942).	No "hedge": capital loss.
Trenton Cotton Oil Co. v. *Commissioner,* 147 F. (2d) 33 (6th Cir. 1945), affirming T. C. Memo Op. (Dec. 28, 1943).	No "true hedge": capital loss.
Estate of Dorothy Makransky, 5 T. C. 397 (1945), aff. 154 F. (2d) 59 (3rd Cir. 1946).	No "true hedge": capital loss.
Stewart Silk Corp., 9 T. C. 174 (1947).	"True hedge": ordinary loss allowed.
Fulton Bag & Cotton Mills, 22 T. C. 1044 (1954).	"True hedge": ordinary loss allowed.

Thus, since all cases involved losses on commodity futures transactions, not gains, when the courts found a "hedge" or later a "true hedge", the taxpayer won. When the courts found no "hedge" or no "true hedge", the taxpayer lost.

The definition of a hedge—a "true hedge", most frequently quoted in these cases is that contained in *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F. (2d) 772 (5th Cir. 1941), where the Court said (p. 774):

> "A hedge is a form of price insurance; it is resorted to by businessmen to avoid the risk of changes in the market price of a commodity. The basic principle of hedging is the maintenance of an even or balanced market position. To exercise a choice of risks, to sell one commodity and buy another, is not a hedge; it is merely continuing the risk in a different form."

A particularly lucid and articulate definition of a "true hedge"[6] is set forth in the opinion of the Court of Appeals in the instant case (R. 295):

> "Hedging is a method of dealing in commodity futures whereby a person or business protects itself against price fluctuations at the time of delivery of the product which it sells or buys. *United States* v. *New York Coffee & Sugar Exchange*, 263 U. S. 611. A typical example of hedging occurs when a manufacturer of grain products

[6] So denominated in the Court's opinion. (R. 297).

seeks to stabilize its costs against fixed forward sales prices. Having contracts for the delivery of its grain products to its customers at fixed prices, the manufacturer seeks to set the cost of its related inventory item, grain, by entering into futures contracts for the purchase of it. By so doing the manufacturer may later obtain the necessary grain at a price properly related to the already fixed selling price of his manufactured product and, so far as commodity costs are concerned, the profit from manufacturing is insured."

It should be noted that while in the earlier cases the courts used the term "hedge" whereas later decisions used the term "true hedge", apparently no difference in concept was intended. Both terms, in fact, described the same type of balanced insuring transactions.

From the foregoing cases and discussion the following principles (in so far as they are relevant here) of "hedging", *i. e.*, "true hedging" can be extracted:

(i) The desirability of hedging stems from the fact that businessmen sometimes make firm commitments for the sale of their manufactured products in advance of making commitments for the purchase of the raw materials from which they are to be manufactured, and, as a consequence, face the risk of rising raw material prices threatening whatever profit might be made on the sales of the manufactured products.

(ii) True hedging is profit insurance—*i. e.*, the relationship between the selling price of manufactured goods (for which there is a firm commitment) and the purchase price of raw materials (not as yet purchased) from which they are to be manufactured will be such that the difference between the two prices will be fixed and a profit will ensue.

(iii) True hedging may be also described as the elimination of the speculative risk of market fluctuations in the prices of manufactured goods (for which there is a firm commitment) and the raw materials (not as yet purchased) from which they are to be manufactured.

(iv) True hedging is accomplished by the acquisition and maintenance of a balanced position. Thus a true hedge may be defined as a balanced position.

(v) A balanced position means the acquisition of commodity futures in an amount roughly equivalent to the amount of commodities (not as yet purchased) needed to manufacture the finished goods in respect of which there are firm commitments at a firm price. Acquisition of the commodity futures takes place at or about the time the given commitments for finished goods are made, and the disposition of the commodity futures takes place at or about the time the actual commodities to be manufactured into finished goods are acquired.

(vi) To exercise a choice of risks to sell one commodity and buy another is not a "true hedge"; it is merely continuing the risk in a different form.

The operation of these principles can clearly be seen from one of the two type situations[7] involving hedging transactions set forth in G. C. M. 17322 referred to above. It was illustrated as follows:

"(2) The taxpayer makes contracts for future delivery of cotton goods, the manufacture of which will require more cotton than the amount on hand or the amount which can be immediately purchased advantageously. In order to secure protection against a rising cotton market during the months that intervene between the date of the order for cotton goods and the agreed delivery date, the taxpayer, at the same time the above orders are taken, enters into futures purchase contracts for cotton in amounts necessary to provide the desired protection. As the taxpayer from time to time buys spot cotton for the manufacture of the goods specified in the above orders, the futures purchase contracts are disposed of by futures sale contracts which serve as offsetting transactions closing out the futures purchase contracts."

In the G. C. M. illustration, the taxpayer fixes the price of the cotton goods he sells for future delivery

[7] The other type situation, i. e., the sale of commodity futures against inventory, is not involved here.

on the basis of present raw cotton prices, the price of the cotton goods allowing for his manufacturing profit. In the interval between the time when he makes the contract for the sale of cotton goods and the time when he will acquire the actual raw cotton to manufacture the cotton goods, the price of raw cotton may rise or fall. If it rises, he will lose some or all of his estimated profit. If it falls, he will make an even larger profit than he estimated. To eliminate this speculation, he buys cotton futures in the amount of raw cotton that he needs to fill his contract. This is a balanced position, the cotton futures balancing the raw cotton he will need. Then if the price of raw cotton advances by the time he needs it to fill his cotton goods contract, the price of cotton futures, paralleling the price of raw cotton, will advance, too. So, as he buys the raw cotton that he needs to fill his cotton goods contract, he sells his cotton futures. Thus the amount of the profit which he estimated he would make on his cotton goods contract but which he didn't make due to the rise in the price of raw cotton will have been offset in an equal amount by the profit he will make on his futures transaction. In this way, his estimated profit is insured. If the price of raw cotton declines, he will have a loss on his futures transaction, but this will be offset by an equal amount of increased profit on his cotton goods contract. Again, his estimated profit is insured. Insurance is effected whether the price of raw cotton rises or declines, and all speculative risk of fluctuations in the price of raw cotton

is eliminated. It is the balanced position that insures and protects the profit. This is a hedge; a "true hedge".

(c) *Petitioner's Commodity Futures Transactions Were Not "True Hedges".*

Petitioner's commodity futures transactions were not "true hedges" within the foregoing principles. The salient facts of the instant case clearly show this. They are:

(i) At almost all times Petitioner had on hand sufficient corn and manufactured inventory (stocks) to meet all of its customers' orders (Chart, p. 9). Thus, in respect of its commitments, there was no speculative risk of the fluctuation of the market price of raw material to be eliminated. There was no position to be balanced. Under such circumstances, Petitioner's corn futures purchases were not needed to, and could not possibly, hedge anything.

(ii) The time and amount of Petitioner's purchases of corn futures had no relationship to the time and amount of orders for the sale of its products. Petitioner's plan in respect of its corn futures purchases was to acquire a long futures position of approximately 12 million bushels of corn. There was no attempt to tie purchases of corn futures to orders. There was no attempt to acquire or maintain a balanced position. The

Chart (p. 9) shows this quite graphically. Significantly at the time (July 1, 1941) when Petitioner had the largest amount of orders, its corn futures position was the smallest.

(iii) Petitioner, under its sales policy, in actuality had no commitments for the sale of its products on which it could count. Customers were permitted to, and did, cancel orders in their discretion and, as a result, cancellations were frequent, unpredictable, and substantial. Without firm forward sales commitments, there was nothing to hedge.

(iv) Petitioner had no firm price in sales contracts for its products which it could protect by purchases of corn futures. Its prices were subject to decline to the price on the date of delivery (Exh. 10, R. 67, 105). Without a firm sales price there could not be that insurance of the relationship between the price of manufactured goods and the raw materials from which they are manufactured which is the essence of a "true hedge."[8]

In addition, Petitioner's refined corn sugar, one of its major products, was in direct competition with cane and beet sugar and price protection could have been obtained by Petitioner only by sales of cane sugar futures correlated with purchases of corn futures. But the record discloses no sales of cane sugar futures by Petitioner.

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[8] *In re Corn Products Refining Company*, 13 Agric. Dec. 1117 (1954).

Under such circumstances, corn futures purchases could insure no price relationship, no profit. Therefore there could not be a true hedge. Moreover, a hedge by the sale of sugar futures assumes firm commitments for the sale of Petitioner's products, a firm price in respect of such commitments, and some tie as to time and amount of purchases of corn futures with sales commitments. None of these assumptions is true.

(v) The explanation of Petitioner's acquisition of corn futures lay not in a desire to hedge, but in the following facts set forth in the record. The experience of Petitioner with the droughts of 1934 and 1936 made it fearful that the price of corn would rise precipitously due to short supply. It feared the possibility of a price rise more than that of a price decline. Consequently, Petitioner was unwilling to expose itself to the risk that the price of corn would rise, but was willing to expose itself to the risk that the price of corn would decline. With these factors in mind, and without regard to, or connection with, its sales commitments, Petitioner set about acquiring a long position of twelve million bushels of corn futures. Thus Petitioner was simply exercising its judgment in the purchase of corn futures. In so doing, it was merely exchanging one risk, *i. e.*, that the price of corn would rise, for another, *i. e.*, that the price of corn would decline. It was fixing the price of corn as far as the former risk was con-

cerned, but by so doing it exposed itself to the latter risk—against which it had no insurance whatsoever.

The conclusion is inescapable. Petitioner did not have a "true hedge" in its corn futures transactions. Both The Tax Court and the Court of Appeals concurred in this conclusion (R. 211 and 297).

In its purchases of corn futures it is clear that Petitioner was neither a hedger nor a speculator. It was in the position of the "legitimate capitalists, who exercising their judgment as to the conditions, purchase or sell for future delivery with a view to profit based on the law of supply and demand." *United States* v. *New York Coffee & Sugar Exchange, Inc.*, 263 U. S. 611 (1924).

(3) Action of the Courts Below

(a) *The Theory of The Tax Court in the Instant Case Is Untenable.*

The Tax Court in this case departed from the "true hedge" test which had been established by previous decisions. It found that Petitioner did not have a "true hedge". However, it refused to apply Section 117 and accord capital treatment to Petitioner's commodity futures transactions. In so doing, it introduced a new theory saying (R. 211):

"Although perhaps not conforming technically

to the definition of a hedge,[1] it seems indisputable as our findings show that petitioner's practice of purchasing corn futures was an integral part of its manufacturing business. *Ben Grote*, 41 B. T. A. 247; see *Kenneth S. Battelle*, 47 B. T. A. 117, 127. It would hence be anomalous to view them as purely speculative transactions of a capital nature,[2] . . .

"1 • • • to hedge, i. e., to insure themselves against loss by unfavorable changes in price at the time of actual delivery of what they have to sell or buy in their business; • • •' *United States* v. *New York Coffee & Sugar Exchange, Inc.*, 263 U. S. 611. See Patterson, 'Hedging and Wagering on Produce Exchanges,' (1931), 40 Yale L. J. 843, 846.

"2 • • • For example, if a manufacturer or processor of raw material is short on inventory and makes sales of his finished products for forward delivery, the appropriate hedging transaction in that instance would be the purchase of raw material futures at or about the time he makes the sale.' *Stewart Silk Corp.*, 9 T. C. 174, 178."

The theory of The Tax Court that Petitioner's transactions in corn futures, which are clearly "capital assets" under Section 117(a), cease to be capital transactions because they are a *practiced, integral part of its business* is indeed novel. Such a theory flies directly into the teeth of Section 117, which, by its terms, is expressly applicable to *all* non-specifically exempted transactions in *all* non-specifically excluded property, "whether or not connected with his [the taxpayer's] trade or business." There is nothing at all in the section that even remotely suggests that

transactions in "capital assets", regularly practiced as an integral part of a business, should be given ordinary gain or loss treatment, whereas purely speculative (or, the Court seems to indicate, perhaps isolated) transactions in "capital assets" should be given capital gain or loss treatment.

The theory presents a far more sweeping unwritten exception to Section 117 than that of hedging and one that is, to say the least, completely amorphous. Under it, Section 117 might not apply to any sales or exchanges of "capital assets" of a corporation for all such transactions might well be said to be an integral part of the corporate business. Certainly all such transactions might well be said to be non-speculative (and many of them might be non-isolated).

This is judicial legislation of the rankest sort. No justification for it is spelled out by the Court. No obscure intention of Congress is found. The theory seems to come out of thin air.

The Tax Court's theory was not supported by the Court of Appeals, and in its most recent pronouncement The Tax Court has gone back to the "true hedge" test. *Fulton Bag and Cotton Mills*, 22 T. C. 1044 (1954). In this case the Court said:

> "We have viewed the facts on the present record in light of the foregoing definition handed down in the *Farmers & Ginners Cotton Oil Co.*

> case, * * * and have concluded that the futures transactions entered into by petitioner during the fiscal years involved were *true hedging* operations to insure it against the risks of the cotton market. We have so found as a fact, and here hold, that the losses sustained by petitioner as a result thereof are deductible in full as ordinary losses or as cost of goods sold." (Emphasis supplied.)

(b) *The Theory of the Court of Appeals in the Instant Case Is Untenable.*

The Court of Appeals in the instant case also departed from the true hedge test but took an entirely different tack than the Tax Court. It found that Petitioner's commodity futures transactions did not constitute "true hedges", saying (R. 296):

> "The futures transactions of this petitioner, it is true, did not constitute what is known as *'true' hedging.* The *true hedge* can occur only when forward sales prices are fixed and the relation between commodity purchase and later sales price is insured against both increase and decrease of commodity prices. As the forward sales prices here were based mainly on the lower of order or market prices, the petitioner was protected only against increases in commodity prices and did not have the complete insurance of the *true hedge.*" (Emphasis supplied.)

Nevertheless, the Court held that Section 117 was not applicable to Petitioner's commodity futures transactions. To reach this conclusion, the Court first said that hedging was not an exception to Section 117 (R. 296):

> "The tax treatment of hedges, then, is not a 'judge-made exception' to Section 117(a); it is simply a recognition by the courts that property used in hedging transactions properly comes within the exclusions of the section."

The Court then said that while Petitioner's commodity futures transactions did not constitute true hedging, the property "was used for essentially the same purpose and in the same manner as in true hedging" (R. 297).

Then the Court concluded that "for the same reasons that the true hedge is not accorded capital treatment under Section 117(a), the kind of transactions with which we are now concerned are not to be regarded as capital ones either" (R. 297).

Petitioner agrees completely with the Court on two of its propositions: (i) that Petitioner's commodity futures transactions did not constitute "true hedging"; (ii) that hedging is not an exception to Section 117(a). These propositions, it is believed, have been amply demonstrated hereinabove.

However, the Court's proposition that while hedging is not an exception to Section 117(a), the prop-

erty used in hedging comes within the exclusions of the Section, is a proposition with which Petitioner disagrees.

What were the exclusions to Section 117(a) in the tax years 1940 and 1942? These were (and there were then no others):

(i) Stock in trade.

(ii) Inventory.

(iii) Property held for sale to customers.

(iv) Depreciable property used in business.

(v) Land used in business (after January 1, 1942).

Quite obviously Petitioner's commodity futures were neither (i), (iii), (iv) nor (v). The Court itself seems to think of Petitioner's commodity futures as (ii)—inventory.[9] But this is clearly wrong. Inventory is raw materials and supplies which will physically become a part of merchandise intended for sale. This is the Commissioner's own definition of inventory, promulgated pursuant to express Congressional mandate.[10] Petitioner's commodity futures were not that sort of property at all; they were not inventory. The Tax Court so held (R. 212) in the instant case, citing *Modesto Dry Yard Inc.*, 14 T. C. 374 (1950). Acq.

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[9] Actually the Court's opinion is not particularly clear on this point, but if it means anything, it must mean this.

[10] Section 22(c), Regulations 103, Sec. 19.22(c)-1.

The Court's proposition that, while Petitioner's commodity futures transactions did not constitute hedging, the commodity futures were "used for essentially the same purpose and in the same manner as in true hedging," is a proposition with which Petitioner disagrees.

What exactly do the words "for essentially the same purpose and in the same manner as in true hedging" mean in this connection? How can purpose or manner be relevant here? If vital elements of a hedge are lacking, as they are here, so that the transaction does not accomplish what a hedge is supposed to accomplish, should that transaction be treated as a hedge because of its purpose or manner?

The Court of Appeals seems to be saying that if a transaction is something like a hedge, even though it is not a hedge, it should be treated as a hedge.[11] But that does not seem to mean much of anything. How much like a hedge must a transaction be to be treated as a hedge, when in fact it is not a hedge and does not do what a hedge is supposed to do? The proposition raises many more questions than it answers.

Actually, the facts set forth above (pp. 28, 29, 30, 31) show that Petitioner's commodity futures transactions had no resemblance to a hedge. And the one single fact—that seems completely to have escaped the

[11] This was the gist of the Respondent's argument to the Court of Appeals.

Court's attention—which makes it abundantly clear that there was no such resemblance is this: *Petitioner at almost all times had sufficient corn and inventory on hand to meet all of its sales commitments (whatever their character because they were not firm).*[12] A glance at the chart (p. 9) will reveal this. There was, therefore, nothing to hedge.

Since Petitioner at almost all times had ample corn and inventory on hand to meet all sales commitments, Petitioner's commodity futures purchases had no balancing function at all. Under such circumstances it is clear that Petitioner was not hedging and did not have anything remotely resembling a hedge.

For these and other reasons set forth above, exception is taken to the Court of Appeals' conclusion, to wit: Petitioner's commodity futures transactions are excluded from capital gain and loss treatment pursuant to Section 117.

In passing it may not be amiss to observe that the tendency of The Tax Court and the United States Court of Appeals, Second Circuit, to depart from the definition of capital assets laid down by Congress in Section 117(a) is becoming more pronounced. See *Commissioner* v. *The Bagley & Sewall Co.* (C. A. 2nd,

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[12] Other facts negativing resemblance to a hedge are:

a. No tie in time and amount between purchases of commodity futures and sales commitments.
b. Lack of firm forward sales commitments.
c. Lack of firm sales price.
d. Uncontrollable price of sugar.

1955), — F. (2d) —, affirming 20 T. C. 983, where Judge Frank, in his dissenting opinion, pointed out:

> "The last clause of Section 117(a)(1) is illuminating: From 'capital assets' it excepts 'real property'—no other—if 'used in the trade or business of the taxpayer.' My colleagues, in effect, treat that clause as if it read 'any property used in the trade or business of the taxpayer.' This, I think, an improper judicial amendment of the statute.
>
> * * * *
>
> "My conclusion here derives from no ardent desire to add to the government's revenues by invariably interpreting statutes adverse to taxpayers; see, e. g., my dissenting opinion in *Babcock & Wilson* [sic] *Co. v. Pedrick*, 217 Fed. (2d) 654 (C. A. 2). But I think that courts should not allow what they deem fairness to taxpayers to override one of the most sensible canons of statutory construction, i. e., that, where a statute sets forth specific exceptions, further exceptions, by way of mere implication, are not permissible. Moreover, to hold for the taxpayer here may well mean unfairness to other taxpayers who, having acquired securities in situations just like this, but having made a gain on the sale of the securities, seek to claim that their taxable profits are capital gains, not ordinary income."

The extra-statutory deviations of The Tax Court and the Second Circuit with respect to Section 117(a)

have become notable. There is printed in Appendix B at page 69 a brief extract from a tax bulletin of Research Institute of America on the subject.

(4) A Case in Point

The case closest factually to the instant case is *Estate of Dorothy Makransky, et al.*, 5 T. C. 397 (1945), aff'd 154 F. (2d) 59 (3rd Cir., 1946). In that case, the taxpayer was engaged in the business of manufacturing men's suits from piece goods. Each fall its salesmen took firm orders for spring and summer delivery at fixed prices. At the outbreak of World War II, all lines of piece goods were withdrawn from the market, and the taxpayer had on hand only a six months' supply. Taxpayer several times in the past had purchased wool tops and contracted with manufacturers of wool yarn and cloth to make piece goods from wool tops. During September, 1939, the taxpayer purchased futures contracts calling for the delivery of a year's supply of wool tops in March, 1940. Toward the close of 1939, piece goods were again offered on the market, and the taxpayer learned that the wool tops to be delivered in March were of a grade unsuitable for the manufacture of its piece goods. During February, 1940, the taxpayer sold the futures contracts at a substantial loss. The Tax Court held, and the Court of Appeals affirmed, that this was not a true hedging transaction, and, that therefore, the loss was a capital loss.

The taxpayer in the *Makransky* case was concerned, because of war conditions, with having available a

supply of raw materials "at a price". Petitioner was concerned because of droughts with having available a supply of raw materials "at a price". In neither case was there any insurance, *i. e.*, profit insurance or the fixing of the relationship between the market prices of manufactured goods and raw materials. In neither case was there the maintenance of the balanced market position that produces such insurance. In neither case was there the elimination of speculative risks due to fluctuations in the market price. In neither case was there a hedge. In the *Makransky* case it was so held and that as a consequence Section 117 of the Internal Revenue Code was applicable. Reasoning parallel to that in the *Makransky* case had been applied by the Courts of Appeal in denying taxpayers ordinary losses in *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. (2d) 33 (6th Cir., 1945), and *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F. (2d) 772 (5th Cir., 1941) at the urging of the Commissioner of Internal Revenue. In the instant case, The Tax Court also found that there was no hedge, and the Court of Appeals affirmed this finding. Yet both Courts held that Section 117 was not applicable. These cases cannot be reconciled with the instant case.

Conclusion

The plain fact is that Petitioner's commodity futures had no offsetting relationship or tie to any of its sales commitments. They were not so intended.

The intention was simply to acquire a long futures position (R. 52). Petitioner was buying corn futures when it thought that the circumstances indicated that it was good judgment to buy them. It sold them on the same basis. Petitioner was only protecting itself against a rise in the price of corn. Petitioner had no insurance of profit. It had no balanced position. Consequently it exposed itself gratuitously to a different risk, *i. e.*, of the decline of the price of corn.

The inescapable conclusion is that Petitioner was not hedging.[13] It was the legitimate capitalist referred to in this Court's opinion in *United States* v. *New York Coffee & Sugar Exchange, Inc.*, 263 U. S. 611 (1924), the third type of person who deals in commodity futures, the forgotten man of 66 C. M. 17322 referred to above.

Petitioner therefore respectfully submits:

1. Section 117 is applicable to Petitioner's commodity futures transactions. The statute is specifically addressed to the problem and clearly covers it.

2. Hedging is not a justifiable exception to Section 117. The statute contains no such exception. It is clear and unambiguous. It neither requires nor leaves room for construction or interpretation.

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[13] See *In re Corn Products Refining Company*, 13 Agric. Dec. 1117 (1954), where the Secretary of Agriculture with his expertise in this field, so held upon scrutiny of Petitioner's corn futures transactions of the same nature for later years.

3. Petitioner's transactions did not, in fact, constitute "true hedging," the criterion for the "hedging exception" established by the weight of judicial authority. This was affirmatively found by both The Tax Court and the Court of Appeals. It is clear from the facts.

4. The theories of The Tax Court and the Court of Appeals are both untenable. Whatever theoretical justification there may be for a hedging exception to Section 117, cannot be extended under the theories propounded by the Courts below to the facts in this case.

II

Commodity Futures Transactions are Subject to the Wash Sales Provisions of Section 118 of the Internal Revenue Code.

The Tax Court of the United States and the United States Court of Appeals for the Second Circuit have both declined to apply the so-called "wash sales" provisions of Section 118 of the Internal Revenue Code of 1939 to transactions in commodity futures. The direct conflict between the Second Circuit and the Sixth Circuit in *Trenton Cotton Oil Co. v. Commissioner*, 147 F. (2d) 33; (6th Cir., 1945) has already been noted in the opinion below (R. 297).

The basic purpose of Section 118 is to eliminate the use of "paper losses" by denying a taxpayer the right to claim a deduction where, within a thirty-

day period before or after the sale, substantially identical stock or securities have been acquired. This statutory prohibition should apply with equal vigor to both stock and commodity transactions.

Prior to November 24, 1921, losses on sales of securities could be deducted, even though a taxpayer repurchased the same securities on the same day and at the same price as the securities sold. Congress, pointing out the "evasion through the medium of wash sales", in the reports of both its Houses, enacted in the Revenue Act of 1921 the so-called "wash sales" provision disallowing losses on sales of stock or securities where within 30 days before or after the transaction taxpayer acquired substantially identical property. This same provision appeared in Section 118 of the Internal Revenue Code of 1939. The issue in this case turns on the meaning of the word "security".

A. The Meaning of the Term "Security"

The only definition of the word "security" in the Internal Revenue Code of 1939, which is not restricted to securities issued by a corporation, is that appearing in Section 3672(b)(2), which includes not only all corporate and government securities, but any negotiable instrument as well.

This Court has established that the language in the Revenue Acts is to be taken in its ordinary meaning, unless the context or legislative history of the enact-

ment compels a different interpretation. *Old Colony R. R. Co. v. Commissioner*, 284 U. S. 552, 560.

Webster's New International Dictionary defines the word "security" as "an evidence of debt or of property, as a bond, stock certificate, or other instrument, etc.; a document giving the holder the right to demand and receive property not in his possession."

The history of the word "securities" is of some interest. It comes from two Latin words—*se* (without) plus *cura* (care).

Mr. Justice Kekewich's language in the English case, *In re Johnson*, 89 L. T. 84 (1903), has been much quoted in this country:

> "Of course it is well known that 'security' really means something which frees you from care—that is, care as to money which you have invested, the principal and perhaps the interest too—something which frees you from care, and enables you, as regards that particular investment, to be, to use a poetical expression, like 'the gods that live at ease.'"

The word has never become a legal term of art. The concept was originally applied only to mortgage debt by the Courts and did not include stock or unsecured debentures. It was later extended and has come to have the broad meaning appearing in Webster's New International Dictionary, which was adopted in *Tron-*

ton Cotton Oil Co. v. Commissioner, 147 F. (2d) 33 (6th Cir. 1945), where the Court said:

> "It may be that when petitioner sold futures contracts and repurchased others of a like amount there was a constructive delivery of the cottonseed oil to petitioner and a constructive re-delivery to the broker, but considering the substance of the transactions rather than their form petitioner had no more than a document giving it the right to demand and receive property not in its possession. This is a security."

This Court has said, in construing the term "securities", that "courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in the particular cases the generally expressed legislative policy." (*Securities and Exchange Commission* v. *Joiner Leasing Corp.*, 320 U. S. 344, 350-351 (1943)).

We have pointed out that the evidence in this case shows that a corn futures contract dealt with on a regulated exchange consists of a document (Exhibits 14 and 15, R. 89 and 151, 90 and 152) evidencing a right to buy 5,000 bushels of corn or some multiple thereof, of a stated quality, at a stated price, upon delivery during a stated month in the future, and calls for the actual receipt and delivery of the property

and payment therefor (R. 89, 90, 151, 152). This is clearly a "security" in the generally accepted sense of the term.

In the present case the vast majority of Petitioner's transactions in commodity futures was transacted for it by brokers on the floor of the Chicago Board of Trade (R. 89, 91). This regulated exchange not only lists various commodities, but also stocks and bonds (R. 94). The same broker can buy or sell either commodity futures or stocks and bonds on margin for the same client without leaving the floor of that exchange. Congress must have intended that a taxpayer operating through the same broker on the same exchange should receive the same treatment, as far as "wash sales" are concerned, in the case of commodity futures as in the case of stocks and bonds.

How would Respondent treat "when-issued securities"[14] and "puts" and "calls" which in common with commodity futures, are all papers written by a broker? They are all, in common, negotiable and can be purchased either on margin or for a fraction of the cost of the underlying stock. Transactions in these securities should receive identical treatment, under Section 118, with stocks and bonds. Any other interpretation would allow the deduction of paper losses representing no economic change of position, which the statute was designed to prevent.

[14] This Court in *Chicago Board of Trade* v. *Christie Grain & Stock Company*, 198 U. S. 236, at page 248; likened futures trading to stock trading for future delivery.

In *Trenton Cotton Oil Co. v. Commissioner*, 147 F. (2d) 33 (6th Cir., 1945), the Court of Appeals said at page 37:

> "The sole purpose of the statute was to prevent the deduction of losses from net income and the Congress set up as a barrier a more or less arbitrary standard to overcome the evil. Unless losses from dealings in commodity futures through a broker are within the statute, the barrier is weakened, because the dealings in such property on exchanges of the country is almost as extensive as that in stocks and bonds."

B. The Meaning of the Term "Substantially Identical"

There is one further point with respect to Section 118—the question of whether one commodity future is substantially identical to another. Petitioner's witness, Henry, testified that one commodity contract for 5,000 bushels was identical to any other contract for 5,000 bushels (R. 89, 90). It was not merely substantially identical. All contracts mature within a single year—usually in the months of May, July, December, and occasionally March and October (R. 54). In each case the contract is written by a recognized broker on the floor of a regulated exchange for the benefit of his customer who generally buys on margin. The broker takes the margin and thereafter the contract is sold to the customer of some other broker who also normally buys on margin. The seller or

purchaser, as the case may be, is not known to the other party buying or selling and, consequently, their identities are of no economic significance. The parties accept the Board of Trade responsibility for the commodity brokers. This contract is negotiable and can be sold and resold until maturity. Normally, as in the instant case, settlement is made prior to maturity, so that only in rare instances do the parties take delivery. See *George W. Covington*, 42 B. T. A. 601 (1940); aff. 120 F. (2d) 768 (5th Cir., 1941), cert. denied 315 U. S. 822 (1942).

The case of *Marie Haulin, et al.*, 38 B. T. A. 811 (1938), affirmed 108 F. (2d) 429 (3rd Cir., 1939), discussed at some length the meaning of the word "substantially", with the absolute noun "identical". It compared this term, as used in Section 118, with the corresponding adjective and absolute "substantially all," which appeared in Section 203(h)(i)(A) of the Revenue Act of 1926; and noted that the cases under the reorganization sections held variously that where all or all but 10% or 15% of the property was acquired, the statutory test was met. There is, of course, some small economic difference in the value of different maturities of corn futures within a year on any given day. A reference to the published quotations in the daily newspaper will show, however, that the difference in economic value is well within the 10% or 15% limit set forth in the *Haulin* case.

To hold that under such circumstances commodity futures contracts do not come within the provisions of Section 118 defeats the underlying purpose of the statute and is untenable.

C. Cases Cited Below Are Distinguishable

The cases cited by the Court of Appeals in support of its position that commodity futures are not subject to the "wash sales" provisions do not involve Section 118 or the question of wash sales. *Harriss* v. *Commissioner*, 143 F. (2d) 279 (2nd Cir., 1944); and *Valley Waste Mills* v. *Page*, 115 F. (2d) 466 (5th Cir., 1941), cert. denied 312 U. S. 681.

These cases merely hold that if a commodity contract is disposed of, it is a completed transaction for purposes of computing *gain* and is not a tax-free exchange within the purview of the provisions of Section 112 of the Internal Revenue Code. Section 118 has no reference whatsoever to gains, which are recognized in the year in which they occur. It merely prevents the taking of *paper losses* where there has been no change in economic position. There has never been any contention here by Petitioner, where it closed out a transaction at a profit, that the profit was not recognized at once within the rationale of the two cited cases.

It is respectfully submitted that the corn futures transactions of Petitioner on regulated exchanges

were subject to the "wash sales" provisions of Section 118. To hold otherwise would be to leave the door open to grave abuse.

CONCLUSION

It is urged that for the foregoing reasons the judgment of the Court below should be reversed.

Respectfully submitted,

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Dated: Aug. 23, 1955.

APPENDIX A

INTERNAL REVENUE CODE OF 1939

SEC. 117. CAPITAL GAINS AND LOSSES (AS AMENDED BY SECS. 212 (a) and (b), 214(c) and 229, REV. ACT 1939).

(a) Definitions.—As used in this chapter—

(1) CAPITAL ASSETS.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l);

(2) SHORT-TERM CAPITAL GAIN.—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such gain is taken into account in computing net income;

(3) SHORT-TERM CAPITAL LOSS.—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such loss is taken into account in computing net income;

(4) LONG-TERM CAPITAL GAIN.—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income;

(5) LONG-TERM CAPITAL LOSS.—The term "long-term capital loss" means loss from the sale or exchange of

a capital asset held for more than 18 months, if and to the extent such loss is taken into account in computing net income;

(6) NET SHORT-TERM CAPITAL GAIN.—The term "net short-term capital gain" means the excess of short-term capital gains for the taxable year over the sum of (A) short-term capital losses for the taxable year, plus (B) the net short-term capital loss of the preceding taxable year (if beginning after December 31, 1937), to the extent brought forward to the taxable year under subsection (e);

(7) NET SHORT-TERM CAPITAL LOSS.—The term "net short-term capital loss" means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year;

(8) NET LONG-TERM CAPITAL GAIN.—The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year;

(9) NET LONG-TERM CAPITAL LOSS.—The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

(b) Percentage taken into account.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 18 months;

66⅔ per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

50 per centum if the capital asset has been held for more than 24 months.

(c) Alternative taxes.—

(1) In case of net long-term capital gain.—If for any taxable year a taxpayer (other than a corporation) derives a net long-term capital gain, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of the net long-term capital gain, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 30 per centum of the net long-term capital gain.

(2) In case of net long-term capital loss.—If for any taxable year a taxpayer (other than a corporation) sustains a net long-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is greater than the tax imposed by such sections:

A partial tax shall first be computed upon the net income increased by the amount of the net long-term capital loss, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax minus 30 per centum of the net long-term capital loss.

(d) Limitation on capital losses.—

(1) Corporations.—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States (including laws relating to the District of

Columbia) or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

(2) OTHER TAXPAYERS.—In the case of a taxpayer other than a corporation, short-term capital losses shall be allowed only to the extent of short-term capital gains. [See amendment of subsection (d) by section 212(a) of Revenue Act of 1939, set forth below.]

(e) Net short-term capital loss carry-over.—If any taxpayer (other than a corporation) sustains in any taxable year beginning after December 31, 1937, a net short-term capital loss, such loss (in an amount not in excess of the net income for such year) shall be treated in the succeeding taxable year as a short-term capital loss, except that it shall not be included in computing the net short-term capital loss for such year. [See amendment of subsection (e) by section 212(b) of Revenue Act of 1939, set forth below.]

(f) Retirement of bonds, etc.—For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

(g) Gains and losses from short sales, etc.—For the purpose of this chapter—

(1) gains or losses from short sales of property shall be considered as gains or losses from sales or exchanges of capital assets; and

(2) gains or losses attributable to the failure to exercise privileges or options to buy or sell property shall be considered as short-term capital gains or losses.

(h) Determination of period for which held.—For the purpose of this section—

(1) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged.

(2) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(3) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain was recognized to the distributee under the provisions of section 112(g) of the Revenue Act of 1928, 45 Stat. 818, or the Revenue Act of 1932, 48 Stat. 705, or under the provisions of section 371(c) of the Revenue Act of 1938 or this

chapter, there shall be included the period for which he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

(4) In determining the period for which the taxpayer has held stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 118 of this chapter or section 118 of the Revenue Act of 1928, 45 Stat. 826, or the Revenue Act of 1932, 47 Stat. 208, or the Revenue Act of 1934, 48 Stat. 745, or the Revenue Act of 1936, 49 Stat. 1692, or the Revenue Act of 1938, 52 Stat. 503, relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, there shall be included the period for which he held the stock or securities the loss from the sale or other disposition of which was not deductible. [See amendment of subsection (h) by section 214(c) of Revenue Act of 1939, set forth below.]

SEC. 212. CORPORATION CAPITAL LOSSES. (REVENUE ACT OF 1939.)

(a) Limitations.—Section 117(d) of the Internal Revenue Code (relating to limitation on capital losses) is amended to read as follows:

"(d) Limitation on capital losses.—Long-term capital losses shall be allowed; but short-term capital losses shall be allowed only to the extent of short-term capital gains."

(b) Net short-term capital loss carry-over.—Section 117(e) of the Internal Revenue Code (relating to the one-year carry-over of net short-term capital loss) is amended to read as follows:

"(e) Net short-term capital loss carry-over.—If any taxpayer sustains in any taxable year, beginning after

December 31, 1937, in the case of a taxpayer other than a corporation, or beginning after December 31, 1939, in the case of a corporation, a net short-term capital loss, such loss (in an amount not in excess of the net income for such year) shall be treated in the succeeding taxable year as a short-term capital loss, except that it shall not be included in computing the net short-term capital loss for such year."

* * * * * *

SEC. 229. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE. (REVENUE ACT OF 1939.)

Except the amendments made by sections 211, 213, 214, 215, 217, 219, 220, 221, 222, 223, 226, 227, and 228, the amendments made by this title to the Internal Revenue Code shall be applicable only with respect to taxable years beginning after December 31, 1939.

SEC. 214. BASIS OF STOCK DIVIDENDS AND STOCK RIGHTS. (REVENUE ACT OF 1939.)

* * * * * *

(c) Determination of period for which held.—Section 117(h) of the Internal Revenue Code (relating to determination of period for which property is held) is amended by adding at the end thereof the following new paragraph:

"(5) In determining the period for which the taxpayer has held stock or rights to acquire stock received upon a distribution, if the basis of such stock or rights is determined under section 113(a)(19)(A), there shall (under regulations prescribed by the Commissioner with the approval of the Secretary) be included the period for which he held the stock in the distributing corporation prior to the receipt of such stock or rights upon such distribution."

(d) Taxable years to which applicable.—The amendments made by subsections * * * (c) shall be applicable to taxable years beginning after December 31, 1938.

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES [AS AMENDED BY SECS. 212(a)(b), 214(c); REV. ACT 1939; SEC. 115(b), REV. ACT 1941; SECS. 150(a)(b)(c)(d), 151(a)(b)(c), 152, REV. ACT 1942].

(a) DEFINITIONS.—As used in this chapter—

(1) CAPITAL ASSETS.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer.

(2) SHORT-TERM CAPITAL GAIN.—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing net income;

(3) SHORT-TERM CAPITAL LOSS.—The term "short-

term capital loss" means loss from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such loss is taken into account in computing net income;

(4) LONG-TERM CAPITAL GAIN.—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

(5) LONG-TERM CAPITAL LOSS.—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such loss is taken into account in computing net income;

(6) NET SHORT-TERM CAPITAL GAIN.—The term "net short-term capital gain" means the excess of short-term capital gains for the taxable year over the short-term capital losses for such year;

(7) NET SHORT-TERM CAPITAL LOSS.—The term "net short-term capital loss" means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year;

(8) NET LONG-TERM CAPITAL GAIN.—The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year;

(9) NET LONG-TERM CAPITAL LOSS.—The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

(10) NET CAPITAL GAIN.—

(A) Corporations.—In the case of a corporation, the term "net capital gain" means the excess of the

gains from sales or exchanges of capital assets over the losses from such sales or exchanges; and

(B) Other Taxpayers.—In the case of a taxpayer other than a corporation, the term "net capital gain" means the excess of (i) the sum of the gains from sales or exchanges of capital assets; plus net income of the taxpayer or $1,000, whichever is smaller, over (ii) the losses from such sales or exchanges. For purposes of this subparagraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets.

(11) Net capital loss.—The term "net capital loss" means the excess of the losses from sales or exchanges of capital assets over the sum allowed under subsection (d). For the purpose of determining losses under this paragraph, amounts which are short-term capital losses under subsection (e)(1) shall be excluded.

(b) Percentage Taken Into Account.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

(c) Alternative Taxes.—

(1) Corporations.—If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sec-

tions 13, 14, 15, 204, 207(a) (1) or (3), and 500, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 25 per centum of such excess.

(2) OTHER TAXPAYERS.—If for any taxable year the net long-term capital gain of any taxpayer (other than a corporation) exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 50 per centum of such excess.

(d) LIMITATION ON CAPITAL LOSSES.—

(1) CORPORATIONS.—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

(2) OTHER TAXPAYERS.—In the case of a taxpayer, other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income of the taxpayer of[1] $1,000, whichever is smaller. For purposes of this paragraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets.

[1] So in original.

(e) CAPITAL LOSS CARRY-OVER.—

(1) METHOD OF COMPUTATION.—If for any taxable year beginning after December 31, 1941, the taxpayer has a net capital loss, the amount thereof shall be a short-term capital loss in each of the five succeeding taxable years to the extent that such amount exceeds the total of any net capital gains of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year. For purposes of this paragraph a net capital gain shall be computed without regard to such net capital loss or to any net capital losses arising in any such intervening taxable years.

(2) RULE FOR APPLICATION OF CAPITAL LOSS CARRY-OVER FROM 1941.—The amount of the net short-term capital loss of the last taxable year beginning in 1941 (computed without regard to amounts treated as short-term capital losses from the preceding taxable year), which is not in excess of the net income for such taxable year, shall, to the extent of the net short-term capital gain for the succeeding taxable year (computed without regard to this paragraph), be a short-term capital loss of such succeeding taxable year.

(f) RETIREMENT OF BONDS, ETC.—For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

(g) GAINS AND LOSSES FROM SHORT SALES, ETC.—For the purpose of this chapter—

(1) gains or losses from short sales of property

shall be considered as gains or losses from sales or exchanges of capital assets; and

(2) gains or losses attributable to the failure to exercise privileges or options to buy or sell property shall be considered as short-term capital gains or losses.

(h) DETERMINATION OF PERIOD FOR WHICH HELD.—For the purpose of this section—

(1) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged. For the purposes of this paragraph, an involuntary conversion described in section 112(f) shall be considered an exchange of the property converted for the property acquired.

(2) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(3) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain was recognized to the distributee under the provisions of section 112(g) of the Revenue Act of 1928, 45 Stat. 818, or the Revenue Act of 1932, 48 Stat. 705, or under the provisions of section 371(c) of the Revenue Act of 1938 or this chapter, there shall be included the period for which

he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

(4) In determining the period for which the taxpayer has held stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 118 of this chapter or section 118 of the Revenue Act of 1928, 45 Stat. 826, or the Revenue Act of 1932, 47 Stat. 208, or the Revenue Act of 1934, 48 Stat. 715, or the Revenue Act of 1936, 49 Stat. 1692, or the Revenue Act of 1938, 52 Stat. 503, relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, there shall be included the period for which he held the stock or securities the loss from the sale or other disposition of which was not deductible.

(5) In determining the period for which the taxpayer has held stock or rights to acquire stock received upon a distribution, if the basis of such stock or rights is determined under section 113(a)(19)(A), there shall (under regulations prescribed by the Commissioner with the approval of the Secretary) be included the period for which he held the stock in the distributing corporation prior to the receipt of such stock or rights upon such distribution.

(6) In determining the period for which the taxpayer has held stock or securities acquired from a corporation by the exercise of rights to acquire such stock or securities, there shall be included only the period beginning with the date upon which the right to acquire was exercised.

(i) Bonds, Etc., Losses of Banks.—For the purposes of this chapter, in the case of a bank, as defined in section 104, if the losses of the taxable year from sales

or exchanges of bonds, debentures, notes, or certificates, or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof) with interest coupons or in registered form, exceed the gains of the taxable year from such sales or exchanges, no such sale or exchange shall be considered a sale or exchange of a capital asset.

(j) GAINS AND LOSSES FROM INVOLUNTARY CONVERSION AND FROM THE SALE OR EXCHANGE OF CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS.—

(1) DEFINITION OF PROPERTY USED IN THE TRADE OR BUSINESS.—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(2) GENERAL RULE.—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses

from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

SEC. 118. LOSS FROM WASH SALES OF STOCK OR SECURITIES.

(a) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 23(e)(2); nor shall such deduction be allowed under section 23(f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business.

APPENDIX B

RESEARCH INSTITUTE OF AMERICA, INC.

TAXATION REPORT

May 5, 1955

Sale of Securities Can Give Ordinary Loss

The courts seem to be swinging to the theory that a loss from the sale of a capital asset bought in order to accomplish another business goal is a fully deductible loss. Earlier cases of both the Tax Court and the Second Circuit had held that regardless of why a capital asset was required, any loss on its sale was a capital loss. (*Logan & Kanawha Coal Co.*, 5 T. C. 1298) Thus where a taxpayer had to buy World's Fair bonds in order to obtain a concession, the loss on the bonds was a capital loss. (*Exposition Souvenir Corp.* v. *Com.*, 163 F. (2d) 283)

Later decisions involving stock purchased to acquire scarce merchandise or to escape burdensome contracts have allowed full deductions. And now the Tax Court and the Second Circuit have held that a loss incurred on the sale of bonds which had been acquired for use as security on a contract gave rise to full deduction.

Taxpayer entered into a contract for the manufacture and delivery of machinery. The contract required it to deposit $800,000 in government bonds to guarantee performance. Having no bonds, it borrowed funds from its bank, which purchased the bonds and held them in escrow in accordance with the contract. On completion of the contract, the bonds were immediately sold at a loss.

The Tax Court upheld taxpayer's right to a full deduction for the loss. The bonds were not bought for investment, but solely to carry out a condition imposed by the contract. Their purchase and sale was merely an incident in the carrying on of taxpayer's regular manu-

facturing and selling business. Since taxpayer had no intention of retaining the bonds after they served their business purpose, they were held for sale in the ordinary course of business. The loss on their sale was held to be deductible as "an ordinary and reasonable expense".

The Second Circuit in a 2-1 decision agrees that a business loss is possible even though the loss qualifies as a capital loss. Where a loss is incurred as part of a business contract, the contract is not to be "dissected" into separate parts. (*Bagley and Sewall Co.*, 20 T. C. 983 (NA), aff'd (CA-2) 4/21/55)

observation: Both the Tax Court and the Second Circuit reconciled their latest case with the earlier contrary *Exposition Souvenir Corp.* case on the ground that the World's Fair bonds were held for investment purposes. There the taxpayer was required to make an investment. But this distinction is very weak and it really seems that the courts have basically changed their views.

observation: Dissenting Judge Frank felt that when Congress said that gains or losses from the sales of capital assets were to be taxed in a certain way, it didn't want any gains or losses which so qualified to be taxed differently. He pointed out that while the taxpayer won in this case, other taxpayers may find that gains which qualify as capital gains may be taxed as ordinary income.

observation: If the majority decision is followed, the gates can be opened to considerable litigation on the question of whether a capital gain or loss is really to be treated as a capital gain or loss.

Is Investment the Test of a Capital Asset?

The courts in the *Bagley and Sewall Co.* case above seem to be adopting the view that a capital asset is one which is bought for *investment*. The law on the other

hand, holds that every asset is a capital asset unless it falls into certain specified groups. The key non-capital asset group is "property held *primarily* for sale to *customers* in the ordinary course of his trade or business" (italics added). It's a long stretch from this to hold that a taxpayer must have acquired property for investment in order to have a capital asset.

In a case involving a transaction in foreign exchange, the Tax Court used the argument that an asset bought for "speculation" rather than for investment can't be a capital asset. Church's English Shoes, Ltd., bought shoes in English pounds in 1935. The cost of the shoes was set up at the then current exchange rate for pounds sterling. In 1947 the account payable was satisfied with cheaper pounds sterling. Taxpayer claimed that the difference was a capital gain. The Tax Court ruled that there was a "speculation" in foreign exchange. "Taxpayer . . . did not actually 'invest' in any foreign exchange in 1935, which 'investment' might provide the basis for the capital gain in 1947. . . . When petitioner purchased pounds sterling in 1947, in order to pay at that time its account payable, the purchase of foreign money was no more than a usual and recurring transaction in the ordinary course of its business." The court held that ordinary income resulted. (*Church's English Shoes, Ltd.*, 24 T. C. No. 9)

observation: Under this theory, a person who *speculates* in stocks and bonds could have ordinary income. It's questionable whether the theory will be stretched this far. But the tendency of the court to talk about a class of non-capital assets which are not investment assets (although there is nothing to this effect in the law) raises a new uncertainty in deciding what is a capital asset.

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In the Supreme Court of the United States

OCTOBER TERM, 1954

CORN PRODUCTS REFINING COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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In the Supreme Court of the United States

OCTOBER TERM, 1954

No. 457

CORN PRODUCTS REFINING COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

OPINIONS BELOW

The pertinent opinions of the Tax Court are (1) an opinion relating to the taxable year 1940 (R. 22–30; Pet. 25–33), reported at 16 T. C. 395, and (2) an unreported memorandum opinion (R. 201–215; Pet. 33–48) relating to the taxable year 1942.[1] The opinion of the Court of Appeals (Pet. 48–56) is reported at 215 F. 2d 513.

[1] In the 1942 case, the Tax Court subsequently rendered a supplemental opinion (R. 216–219), reported at 20 T. C. 503, with respect to a matter not pertinent to the present petition.

JURISDICTION

The judgment of the Court of Appeals was entered on August 25, 1954. (Pet. 48.) A petition for a rehearing (Record, following p. 291) was denied on September 27, 1954 (Pet. 2). The petition for a writ of certiorari was filed on November 22, 1954. The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 1254.

QUESTIONS PRESENTED

1. Whether the Court of Appeals was correct in affirming the holding of the Tax Court that purchases and sales by taxpayer of corn futures on commodity exchanges were consummated in order to obtain protection for its manufacturing business and were comparable to hedges, and hence that such transactions resulted in ordinary, rather than capital, gains and losses within the purview of the Internal Revenue Code of 1939.[2]

2. Whether the Court of Appeals correctly affirmed the Tax Court's holding that the losses sustained by the taxpayer on such transactions in corn futures were not subject to the wash sales provision of Section 118 of the Code.

3. Whether, upon the facts, the Court of Appeals correctly affirmed the decision of the Tax Court that certain dividends declared by foreign corporations and payable to the taxpayer in its

[2] All Code references herein will be to the Internal Revenue Code of 1939.

base period year 1939, in currencies of Brazil and Italy, respectively, were so blocked by applicable foreign exchange restrictions as to not be includible in income for 1939 in arriving at the taxpayer's base period income for the purpose of computing its excess profits tax credit.

4. Whether the Court of Appeals was correct in deciding that Section 732 (c) of the Code deprived that court of jurisdiction to review the decision of the Tax Court with respect to whether certain income should be eliminated from the year 1941 as abnormal income within Section 721 of the Code for the purpose of computing the unused excess profits credit carryover from 1941 to 1942.

STATUTE INVOLVED

Sections 22, 41, 42, 112, 117, 118, 710, 711, 712, 713, 721, 729, and 732 of the Internal Revenue Code of 1939, the pertinent statutory provisions, are set forth in the Appendix, *infra*, pp. 19–31.

STATEMENT

The facts, as found by the Tax Court in the two cases before it (R. 22–25, 202–210) and as stated by the court below in its opinion (Pet. 48–56), may be summarized as follows:

Taxpayer is engaged in the manufacture and sale of corn products, including starches, sugar, sirups, oils, and feeds. The principal product obtained by the taxpayer from raw corn is starch.

Cerelose, one of its major products, is a refined sugar derived from starch which competes with cane and beet sugar. (R. 202.) Its plants have a daily grind capacity of 170,000 bushels, and a raw corn storage capacity of some 2,300,000 bushels, somewhat less than a three-weeks' supply. Between the years 1938 and 1942, its purchases of raw corn ranged from some 35,000,000 to some 60,000,000 bushels annually. (R. 202–203.)

Taxpayer's sales policy has been in general, with certain exceptions, to contract for shipment of its products within 30 days at specified prices, but to give the customer the benefit of market price if lower at the time of delivery. Its policy was also to cancel any unfilled portion of an order at a customer's request. (R. 203.)

For a number of years, it was taxpayer's practice to purchase and sell corn futures contracts through members of a commodity exchange.[3] Taxpayer engaged in futures transactions "as a part of its corn buying program", buying futures when the price was advantageously low, beginning

[3] The Tax Court found that a corn future is a contract calling for the delivery at a stated time, within 11 months or less, of 5,000 bushels of corn or some multiple thereof, of a stated quality, at a stated price. (R. 204.) A seller has the option of delivering the corn on any day during the month in which the contract matures, and of furnishing a different grade, with an appropriate price adjustment. The buyer furnishes his broker with "margin", or a percentage of the price, until delivery is taken or the contract is sold, at which time settlement is made.

its buying each year at harvest time, and selling most of its futures in the early summer if it then appeared that there would be no corn shortage and no great danger of higher prices. If the latter occurred, taxpayer gradually sold its futures as it bought for grinding. (R. 204.)

The futures were not included in taxpayer's inventory, its profits or losses on futures being shown in a "Corn Miscellaneous" account, and the net gain or loss for each year was debited or credited to cost of sales, being treated as a reduction of or addition to cost of goods sold. (R. 204.) For 1940, taxpayer had a net profit of some $680,000 from purchases and sales of futures (R. 24), and for 1942 it had a net loss therefrom of some $109,000. (R. 206.)

Taxpayer's purchases of corn futures did not constitute speculative transactions for profit, but were consummated in order to obtain business protection and to insure the profitable conduct of its business. (R. 206.)

In December of 1938, a Brazilian corporation (Maizena), wholly owned by taxpayer, declared a dividend payable in January of 1939, and set up on its books an account payable to taxpayer of 2,175,000 Brazilian milreis. There were foreign exchange restrictions in Brazil in 1939, restricting (to an extent not disclosed by the record) the transmission of funds out of that country. In 1939, taxpayer did receive out of its dividend

the amount of $4,862.31, the equivalent of 100,649.9 milreis, by bank draft, under circumstances not shown by the record. Taxpayer received the balance of that dividend in 1940. (R. 206–207.)

In 1939, dividends were also declared by certain Italian corporations of which taxpayer was a major stockholder, and the amounts payable to taxpayer, aggregating 4,496,327 lire, were credited by the corporations as accounts payable to taxpayer. There were exchange restrictions in force in Italy in 1939, restricting (to an extent not disclosed by the record) the transmission of funds out of that country. In the latter part of 1939, taxpayer converted the sums of 210,000 and 200,000 lire into United States dollars, through foreign exchange dealers in New York, at unofficial rates (approximately $0.021 per lira). (R. 207–209.)

Taxpayer's bookkeeping practice with respect to foreign dividends payable in blocked currency has been to set up the dividends as receivables, treating them as deferred income, and then recording the amount as income in the year of actual receipt in the United States. Its tax reporting practice has followed that bookkeeping practice. (R. 209.)

The dividends in controversy were not unqualifiedly subject to taxpayer's demand in the year 1939. In that year there was no market for the unconverted Brazilian milreis and the Italian lire

here in controversy, and no one could form an opinion as to their values in that year. (R. 209.)

Taxpayer had no excess profits tax liability for 1941, and in so determining, the Commissioner excluded from taxpayer's excess profits net income for that year the sum of $436,945.36 as abnormal income under Section 721 of the Internal Revenue Code. The Commissioner's computation of the taxpayer's unused excess profits tax credit carryover from 1941 to 1942 did not exclude from the taxpayer's excess profits net income for 1941 that amount of $436,945.36. (R. 210.)

The Tax Court, on the foregoing findings, held, contrary to taxpayer's contentions, (1) that taxpayer's gains and losses from its futures transactions are to be treated for tax purposes as resulting in ordinary income and losses and not as capital gains and losses; (2) that taxpayer's futures transactions are not within the wash sales provisions of Section 118 of the Code; (3) that taxpayer failed to establish its right to the adjustments it sought, so as to increase its 1939 income by the blocked foreign dividends in question, for the purpose of increasing its excess profits credit; and (4) that the amount of certain income was not to be eliminated from the year 1941 as abnormal income under Section 721 of the Code, for the purpose of determining taxpayer's unused excess profits carryover from 1941 to 1942, since

taxpayer had no excess profits tax liability for the year 1941. (R. 26–29, 211–214, 215.)

The Court of Appeals affirmed the Tax Court with respect to its first three holdings, but declined to review the fourth holding on the ground that because of the provisions of Section 732 (c) of the Code it lacked jurisdiction to review. (Pet. 48–56.) Hence, it dismissed the petition to review pro tanto.

ARGUMENT

1. The court below was clearly correct in holding that the resulting gains and losses from taxpayer's purchases and sales of futures are to be treated as ordinary income and losses under Code Section 22 (*infra*, p. 19), rather than as capital gains and losses under Code Section 117 (*infra*, p. 21). The Tax Court had found that taxpayer's purchases of futures did not constitute speculative transactions, but were availed of in order "to obtain business protection and to insure the profitable conduct of the business" (R. 206), and that while not conforming to the technical definition of hedging, taxpayer's transactions were "an integral part" of its manufacturing business, and therefore comparable to hedges. That holding is consistent with the rule, followed in the tax field for many years, that gains or losses from "hedging" transactions are properly considered as ordinary income and losses, and not as capital gains and losses. See G. C. M. 17322, XV–2 Cum. Bull. 151

(1936). *Grote* v. *Commissioner*, 41 B. T. A. 247; *Battelle* v. *Commissioner*, 47 B. T. A. 117; *Stewart Silk Corp.* v. *Comissioner*, 9 T. C. 174. See also *Commissioner* v. *Farmers & G. C. Oil Co.*, 120 F. 2d 772 (C. A. 5th), certiorari denied, 314 U. S. 683; *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33, 35 (C. A. 6th), rehearing denied, 148 F. 2d 208. Cf. *Tennessee Egg Co.* v. *Commissioner*, 47 B. T. A. 558; *Commissioner* v. *Covington*, 120 F. 2d 768 (C. A. 5th), certiorari denied, 315 U. S. 822; *Estate of Makransky* v. *Commissioner*, 5 T. C. 397, affirmed per curiam, 154 F. 2d 59 (C. A. 3d).

The relation of a taxpayer's transactions in futures to his business is plainly a matter of a factual nature, and the affirmance by the Court of Appeals of the Tax Court's holding on this question is no more than a concurrence in the Tax Court's findings. It is settled that these concurrent findings, which are amply supported by the record, will not be reviewed here in the absence of exceptional error. *Comstock* v. *Group of Investors*, 335 U. S. 211, 214.

There is no merit to taxpayer's contention (Pet. 7–10) that the decision of the court below, insofar as it held that taxpayer's transactions in corn futures gave rise to ordinary income and losses, is in conflict with the cases of *Makransky* v. *Commissioner*, 154 F. 2d 59 (C. A. 3d); *Commissioner* v. *Farmers & G. C. Oil Co.*, 120 F. 2d

772 (C. A. 5th), certiorari denied, 314 U. S. 683, and *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33, 35 (C. A. 6th), rehearing denied, 148 F. 2d 208.

As the opinion below indicates (Pet. 51–53), "hedging" is not a term of art defined in the tax laws. Despite apparent differences in terminology, the pertinent decisions of the lower courts are reconcilable in terms of their own facts and present no basic divergence with respect to the legal principles deemed controlling. Thus, in the *Makransky* case, there was involved only an isolated instance of dealings in futures, and not, as here, the consistent practice of a manufacturer availing itself of regular and continuous dealings in futures "for the purpose of stabilizing inventory cost" (Pet. 52). The Tax Court found there that the taxpayers had not used a method of hedging against present sales of its finished products and that their losses on futures transactions were therefore capital losses. The Third Circuit declined, by reason of this Court's decision in *Dobson* v. *Commissioner*, 320 U. S. 489, to review that finding of the Tax Court. In the *Farmers & G. C. Oil Co.* case, the taxpayer had no future commitments on hand to be protected from price variations. In the *Trenton Cotton Oil Co.* case, the taxpayer, a manufacturer of crude oil (for which there was no commodity market) engaged in dealings in futures of refined oil. Further-

more, at the time the taxpayer entered into its futures transactions in refined oil, it had already completed its sales of crude oil. Hence, its future dealings, unlike the instant case, were for the purpose of recouping losses already sustained.

In the instant case, the futures transactions "were entered into to stabilize inventory costs and thus protect profit" (Pet. 53), and the fact that taxpayer achieved only partial protection, *i. e.*, protection only against increases in the price of corn, was not significant, since, as the court below held, whether the futures transactions were utilized to obtain "complete or only partial insurance" was "simply a difference in degree, not in kind" (Pet. 53).[4]

2. On the second question, the court below, in affirming the Tax Court, held that the wash sales provisions of Section 118 of the Code, *infra*, p. 21, were not applicable to taxpayer's transactions in corn futures, because commodity futures cannot be regarded as "securities" within the meaning of that Section and because a new futures commodity contract is not "substantially identical" with any prior futures contract within the meaning of Section 118. We believe that the decision of the court below is correct. The very

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[4] In the court below, petitioner contended that the courts had set up a "judge-made exception" from capital gains or losses treatment as to hedging in commodity futures (Pet. 51). It may be noted that Section 1233 of the Internal Revenue Code of 1954 expressly incorporates such exception.

nature of corn futures would seem to preclude a holding that they are "securities" within the purview of Section 118. And there are indications that Congress did not intend the term "securities" in Section 118 to have so broad a meaning as to include corn futures. Cf. Sections 23 (g) (3) and (k) (3) and 373 (f), and also Section 112 (b) (1) with Sections 332 (b) and 502 (c) of the Internal Revenue Code. It will be observed that in the latter two provisions Congress expressly referred to transactions in commodity futures.

It is true, nevertheless, as taxpayer asserts, that there is a direct and express conflict on this question (see Pet. 53) between the decision of the court below in the instant case and the decision of the Sixth Circuit in the case of *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33. In view of that conflict, we do not oppose the granting of the writ of certiorari to review the second question presented in the petition for a writ of certiorari (Pet. 2). However, the importance of the question appears to be circumscribed. The precise problem does not appear to be one of frequent occurrence,[5] and the 1950 amendment to Section

[5] After the decision in the *Trenton Cotton Oil Co.* case in 1945, the problem does not appear to have again recurred in litigation until the instant case, notwithstanding the fact that the *Trenton Cotton Oil Co.* decision was directly contrary to the rationale of the decisions in *Harriss* v. *Commissioner*, 143 F. 2d 279 (C. A. 2d), and *Valley Waste Mills*

117 of the Code may greatly restrict application of the question to future cases.[6]

3. The Tax Court held that certain Brazilian and Italian dividends were not includible in taxpayer's income for 1939, because they were blocked by foreign exchange restrictions. In so holding, the Tax Court concluded that taxpayer had failed to meet the burden resting upon it of establishing that the foreign dividends were freely convertible into United States dollars in 1939. The affirmance of this holding by the court below was correct and consistent with settled procedural principles.

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v. *Page*, 115 F. 2d 466 (C. A. 5th), certiorari denied, 312 U. S. 681, to which the court below referred in expressing its inability to agree with *Trenton Cotton Oil Co.*

Moreover, the real significance of the applicability of Section 118 in this case lies in the fact that there is involved the determination of the base period income (for the years 1936 through 1939) under the so-called Second World War Excess Profits Tax Law, in which connection taxpayer would, by the application of Section 118, be permitted to eliminate wash losses aggregating $3,100,000 for the years 1938 and 1939 alone. See R. 230.

[6] The plain effect of Section 117 (l), which was added to the Internal Revenue Code of 1939 by Section 211 of the Revenue Act of 1950, c. 994, 64 Stat. 906, would be to limit materially the scope within which the second question is pertinent with respect to dealings in commodity futures. See H. Rep. No. 2319, 81st Cong., 2d sess., pp. 94–96 (1950–2 Cum. Bull. 380, 448–449; S. Rep. No. 2375, 81st Cong., 2d sess., pp. 44–45 (1950–2 Cum. Bull. 483, 515–516). See also R. 29; and Mim. 6243 (1948–1 Cum. Bull. 44), as amended by Mim. 6789 (1952–1 Cum. Bull. 38). Cf. Sec. 1233 of the 1954 Internal Revenue Code.

The decision of the court below on this question to the effect that the "evidence amply supports the Tax Court's conclusion that the petitioner failed to prove free convertibility" (Pet. 55), turned upon the facts and circumstances of this particular case. Taxpayer, however, endeavors to carve out of this issue a refined legal problem as to "the burden of going forward" with the evidence, and asserts that in that respect the decision of the court below is in conflict with *Whitney* v. *Commissioner*, 73 F. 2d 589 (C. A. 3d). (Pet. 12–13.) The contention is without substance.

Taxpayer offered proof merely that in 1939 it converted (at rates considerably below current foreign exchange rates) approximately 100,000 milreis and 410,000 lire into dollars. There was no showing of the manner of conversion. Manifestly, this proof was insufficient to make out a prima facie case that the blocked dividends aggregating 2,175,000 milreis and 4,496,000 lire were freely convertible into United States dollars during the year 1939. Hence, the problem whether the Commissioner was legally charged with the burden of going forward with the evidence did not arise. In the circumstances, it is plain that there is no conflict between the case of *Whitney* v. *Commissioner*, *supra*, and the decision of the court below.

4. The court below properly declined, because of the prohibition contained in Section 732 (c) of the Code, *infra*, pp. 30–31, to review the decision of the Tax Court on the question involving abnormal income under Section 721 of the Code, *infra*, pp. 27–29.

On this question, the decision below is clearly in accord with several decisions in which appellate courts have observed the prohibition of Section 732 (c) against review of "abnormalities" questions under the excess profits tax law of the Second World War, namely: As to a question under Section 721 (*James F. Waters, Inc.* v. *Commissioner*, 160 F. 2d 596 (C. A. 9th), certiorari denied, 332 U. S. 767), as to a question of Section 711 (b) (1) (J) and (K) (*Colonial Amusement Co. of Philadelphia* v. *Commissioner*, 173 F. 2d 568 (C. A. 3d); *Colorado Milling & El. Co.* v. *Commissioner*, 205 F. 2d 551 (C. A. 10th)), or a question under Section 722 (*George Kemp Real Estate Co.* v. *Commissioner*, 182 F. 2d 847 (C. A. 2d), certiorari denied, 340 U. S. 852).

There is no conflict, as alleged (Pet. 13), with *Stimson Mill Co.* v. *Commissioner*, 163 F. 2d 269 (C. A. 9th), certiorari denied, 332 U. S. 824, rehearing denied, 332 U. S. 839; *Dowd-Feder, Inc.* v. *Commissioner*, 173 F. 2d 673 (C. A. 6th); or *Packer Pub. Co.* v. *Commissioner*, 211 F. 2d 612 (C. A. 8th). In the *Stimson Mill* and *Dowd-Feder* cases, decisions of the Tax Court were held

to be reviewable because viewed as involving questions turning on sections *other* than the "abnormalities" sections specified in Section 732 (c). See *George Kemp Real Estate Co.* v. *Commissioner, supra,* p. 849. In the *Packer Pub. Co.* case, the Court of Appeals merely remanded the case to the Tax Court for consideration of an issue as to the right to relief under Section 711 which the Court of Appeals concluded had been (improperly) not passed upon by the Tax Court.[7]

Contrary to the taxpayer's assertion (Pet. 14), the issue which the court below declined to review was one which had arisen and had been determined "solely by reason of" Section 721. See R. 202, 215, and *San Francisco Stevedoring Co.* v. *Commissioner,* 8 T. C. 222, 226–228. Specifically, the issue was whether, in determining the taxpayer's excess profits tax for 1942, certain income could be eliminated from the year 1941 as abnormal within Section 721 for the purpose of computing an unused excess profits credit carryover from 1941 to 1942 even though there was no excess profits tax liability at all, or in

[7] It may be noted that the statements made by the Eighth Circuit in the *Packer Pub.* case (p. 616) as to the scope of the prohibition of Section 732 (c) and as to the holding of the Second Circuit in the *Kemp* case constitute nothing more than dicta.

any event, in 1941. In disposing of the issue, the Tax Court followed its holding in the *San Francisco Stevedoring* case, where it had rejected a similar contention on the ground that it was not supported by the statute (8 T. C., p. 227).

The Tax Court's decision on this issue is correct. As indicated by the Tax Court in the *San Francisco Stevedoring* case (p. 227), the simple but conclusive answer to the contention is that, since the purpose of Section 721 is to give relief so that the excess profits tax for a particular taxable year shall not exceed the tax as provided in Section 721, and since the taxpayer had no excess profits tax liability at all for 1941, Section 721 could have no application to that year. In short, that Section cannot be properly applied merely to increase the excess profits credit carry-over of a year for which no excess profits tax is due.

CONCLUSION

The decision of the court below on Questions Nos. 1, 3, and 4, stated in the petition for certiorari, is clearly correct, there is no conflict of decisions on those issues, and further review thereof is not warranted. The petition should be denied as to those questions. In view of the conflict of decisions on Question No. 2, we do not oppose the granting of the writ to review that question; however, as indicated, *supra*, pp. 12–13,

this Court may consider that the question lacks sufficient general importance to warrant resolution of the conflict at this time.

Respectfully submitted,

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DECEMBER 1954.

APPENDIX

Internal Revenue Code of 1939:

CHAPTER 1—INCOME TAX

* * * * *

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U. S. C. 1946 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.* The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

(26 U. S. C. 1946 ed., Sec. 42.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

(26 U. S. C. 1946 ed., Sec. 112.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l). * * *

* * * * * *

(d) *Limitation on Capital Losses.*—

(1) *Corporations.*—In the case of a cor-

poration, losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. * * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 117.)

SEC. 118. LOSS FROM WASH SALES OF STOCK OR SECURITIES

(a) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 23 (e) (2); nor shall such deduction be allowed under section 23 (f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business.

* * * * *

(26 U. S. C. 1946 ed., Sec. 118.)

CHAPTER 2—ADDITIONAL INCOME TAXES

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[8] As applicable to the year 1942, after amendments by Section 212 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Section 150 (c) of the Revenue Act of 1942, c. 619, 56 Stat. 798, this provision was as follows:

(d) *Limitation on Capital Losses.*—

(1) *Corporations.*—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

SUBCHAPTER E—EXCESS PROFITS TAX

[As added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, which provided that the new subchapter may be cited as the "Excess Profits Tax Act of 1940"].

SEC. 710. IMPOSITION OF TAX.

(a) [as amended by Section 201 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Section 202 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Imposition.*—

(1) *General Rule.*—There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

* * * * *

(b) [as amended by Section 2 (a) of the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, and by Section 204 (a) of the Revenue Act of 1942, *supra*] *Definition of Adjusted Excess Profits Net Income.*—As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in Section 711) minus the sum of:

(1) *Specific exemption.*—A specific exemption of $5,000;

(2) *Excess profits credit.*—The amount of the excess profits credit allowed under Section 712; and

(3) *Unused excess profits credit.*—The amount of the unused excess profits credit adjustment for the taxable year, computed in accordance with subsection (c).

(c) [as amended by Section 204 (b) of the Revenue Act of 1942, *supra*] *Unused Excess Profits Credit Adjustment.*—

(1) *Computation of Unused Excess Profits Credit Adjustment.*—The unused excess profits credit adjustment for any taxable year shall be the aggregate of the unused excess profits credit carry-overs and unused excess profits credit carry-backs to such taxable year.

(2) *Definition of Unused Excess Profits Credit.*—The term "unused excess profits credit" means the excess, if any, of the excess profits credit for any taxable year beginning after December 31, 1939, over the excess profits net income for such taxable year, computed on the basis of the excess profits credit applicable to such taxable year. For such purpose the excess profits credit and the excess profits net income for any taxable year beginning in 1940 shall be computed under the law applicable to taxable years beginning in 1941. The unused excess profits credit for a taxable year of less than twelve months shall be an amount which is such part of the unused excess profits credit determined under the first sentence of this paragraph as the number of days in the taxable year is of the number of days in the twelve months ending with the close of the taxable year.

(3) *Amount of Unused Excess Profits Credit Carry-Back and Carry-Over.*—

(A) *Unused Excess Profits Credit Carry-Back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has an unused excess profits credit, such unused excess profits credit shall be an unused excess profits credit carry-back for each of the two preceding taxable years,

except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such unused excess profits credit over the adjusted excess profits net income for the second preceding taxable year computed for such taxable year (i) by determining the unused excess profits credit adjustment without regard to such unused excess profits credit, and (ii) without the deduction of the specific exemption provided in subsection (b) (1).

(B) *Unused Excess Profits Credit Carry-Over.*—If for any taxable year beginning after December 31, 1939, the taxpayer has an unused excess profits credit, such unused excess profits credit shall be an unused excess profits credit carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such unused excess profits credit over the adjusted excess profits net income for the intervening taxable year computed for such intervening taxable year (i) by determining the unused excess profits credit adjustment without regard to such unused excess profits credit or to any unused excess profits credit carry-back, and (ii) without the deduction of the specific exemption provided in subsection (b) (1). For the purposes of the preceding sentence, the unused excess profits credit for any taxable year beginning after December 31, 1941, shall first be reduced by the sum of the adjusted excess profits net income for each of the two preceding taxable years (computed for each such preceding taxable year (i) by determining the unused excess profits credit adjustment

without regard to such unused excess profits credit or to the unused excess profits credit for the succeeding taxable year, and (ii) without the deduction of the specific exemption provided in subsection (b) (1)).

* * * * *

(26 U. S. C. 1946 ed., Sec. 710.)

SEC. 711. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * * * *

(B) [as amended by Section 207 (a) of the Revenue Act of 1942, *supra*] *Gains and Losses From Sales or Exchanges of Capital Assets.*—There shall be excluded gains and losses from sales or exchanges of capital assets held for more than 6 months.

* * * * *

(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(26 U. S. C. 1946 ed., Sec. 711.)

SEC. 712 [as amended by Section 13 of the Excess Profits Tax Amendments of 1941, *supra*]. EXCESS PROFITS CREDIT—ALLOWANCE.

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in ex-

income before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 712.)

SEC. 713 [as amended by Section 4 of the Excess Profits Tax Amendments of 1941, *supra*, and Section 228 (c) (2) of the Revenue Act of 1942, *supra*]. EXCESS PROFITS CREDIT—BASED ON INCOME:

(a) *Amount of Excess Profits Credit.*—The excess profits credit for any taxable year, computed under this section shall be—

(1) *Domestic Corporations.*—In the case of a domestic corporation—

(A) 95 per centum of the average base period net income, * * *

* * * * *

(b) *Base Period.*—

(1) *Definition.*—As used in this section the term "base period"—

(A) If the corporation was in existence during the whole of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the period commencing with the beginning of its first taxable year beginning after December 31, 1935, and ending with the close of its last taxable year beginning before January 1, 1940; * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 713.)

SEC. 721 [as amended by Section 5 of the Excess Profits Tax Amendments of 1941, *supra*, and Section 221 (a) of the Revenue Act of 1942, *supra*]. ABNORMALITIES IN INCOME IN TAXABLE PERIOD.

(a) *Definitions.*—For the purposes of this section—

(1) *Abnormal income.*—The term "abnormal income" means income of any class includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 125 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

(2) *Separate classes of income.*—* * *

* * * * *

(3) *Net abnormal income.*—The term "net abnormal income" means the amount of the abnormal income less, under regulations prescribed by the Commissioner with the approval of the Secretary, (A) 125 per centum of the average amount of the gross income of the same class determined under paragraph (1), and (B) an amount which bears the same ratio to the amount of any direct costs or expenses, deductible in determining the normal-tax net income of the taxable year, through the expenditure of which such abnormal income was in whole or in part derived as the excess of the

amount of such abnormal income over 125 per centum of such average amount bears to the amount of such abnormal income.

(b) *Amount Attributable to Other Years.*—The amount of the net abnormal income that is attributable to any previous or future taxable year or years shall be determined under regulations prescribed by the Commissioner with the approval of the Secretary. In the case of amounts otherwise attributable to future taxable years, if the taxpayer either transfers substantially all its properties or distributes any property in complete liquidation, then there shall be attributable to the first taxable year in which such transfer or distribution occurs (or if such year is previous to the taxable year in which the abnormal income is includible in gross income, to such latter taxable year) all amounts so attributable to future taxable years not included in the gross income of a previous taxable year.

(c) *Computation of Tax for Current Taxable Year.*—The tax under this subchapter for the taxable year, in which the whole of such abnormal income would without regard to this section be includible, shall not exceed the sum of:

(1) The tax under this subchapter for such taxable year computed without the inclusion in gross income of the portion of the net abnormal income which is attributable to any other taxable year, and

(2) The aggregate of the increase in the tax under this subchapter for the taxable year (computed under paragraph (1)) and for each previous taxable year which would have resulted if, for each previous taxable year to which any portion of such net abnormal income is attributable, an amount

equal to such portion had been included in the gross income for such previous taxable year.

(d) *Computation of Tax for Future Taxable Year.*— * * *

* * * * * *

(e) *Application of Section.*—This section shall be applied only for the purpose of computing the tax under this subchapter as provided in subsections (c) and (d), and shall have no effect upon the computation of base period net income. For the purposes of subsections (c) and (d)—

(1) Net abnormal income means the aggregate of the net abnormal income of all classes for one taxable year.

(2) Under regulations prescribed by the Commissioner with the approval of the Secretary, the tax under this subchapter for previous taxable years shall be computed as if the portions of net abnormal income for each previous taxable year for which the tax was computed under this section were included in the gross income for the other previous taxable years to which such portions were attributable.

(3) If both subsections (c) and (d) are applicable to any current taxable year, subsection (d) shall be applied without regard to subsection (c), and subsection (c) shall be applied as if the tax under this subchapter, except for subsection (c), was the tax computed under subsection (d) and as if the gross income and the other amounts necessary to determine the adjusted excess profits net income were those amounts which would result in the tax computed under subsection (d).

(f) *Abnormal Income From Exploration, Etc.*— * * *

* * * * * *

(26 U. S. C. 1946 ed., Sec. 721.)

SEC. 729. LAWS APPLICABLE.

(a) *General Rule.*—All provisions of law (including penalties) applicable in respect of the taxes imposed by Chapter 1, shall, insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter.

* * * * *

(26 U. S. C. 1946 ed., Sec. 729.)

SEC. 732 [as added by Section 9 of Excess Profits Tax Amendments of 1941, *supra,* and as amended by Sections 222 (c) of the Revenue Act of 1942, *supra,* by Section 2 of the Joint Resolution of June 30, 1945, c. 211, 59 Stat. 295, and by Section 203 (a) of the Act of December 29, 1945, c. 652, 59 Stat. 669]. REVIEW OF ABNORMALITIES BY THE TAX COURT OF THE UNITED STATES.

(a) *Petition to Tax Court.*—If a claim for refund of tax under this subchapter for any taxable year is disallowed in whole or in part by the Commissioner, and the disallowance relates to the application of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, relating to abnormalities, the Commissioner shall send notice of such disallowance to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the ninetieth day) the taxpayer may file a petition with the Tax Court for a redetermination of the tax under this subchapter. If such petition is so filed, such notice of disallowance shall be deemed to be a notice of deficiency

for all purposes relating to the assessment and collection of taxes or the refund or credit of overpayments.

(b) *Deficiency Found by the Tax Court in Case of Claim.*—If the Tax Court finds that there is no overpayment of tax in respect of any taxable year in respect of which the Commissioner has disallowed, in whole or in part, a claim for refund described in subsection (a) and the Tax Court further finds that there is a deficiency for such year, the Tax Court shall have jurisdiction to determine the amount of such deficiency and such amount shall, when the decision of the Tax Court becomes final, be assessed and shall be paid upon notice and demand from the collector.

(c) *Finality of Determination.*—If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Tax Court.

(d) *Review by Special Division of the Tax Court.*—The determinations and redeterminations by any division of the Tax Court involving any question arising under section 721 (a) (2) (C) or section 722 with respect to any taxable year shall be reviewed by a special division of the Tax Court which shall be constituted by the presiding judge and consist of not less than three judges of the Tax Court. The decisions of such special division shall not be reviewable by the Tax Court, and shall be deemed decisions of the Tax Court.

(26 U. S. C. 1946 ed., Sec. 732.)

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In the Supreme Court of the United States

OCTOBER TERM, 1955

CORN PRODUCTS REFINING COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The pertinent opinions of the Tax Court are (1) an opinion relating to the taxable year 1940 (R. 22–30), reported at 16 T. C. 395, and (2) an unreported memorandum opinion (R. 201–215) relating to the taxable year 1942. The opinion of the Court of Appeals (R. 293–299) is reported at 215 F. 2d 513.[1]

[1] The opinion of the court below, as well as the memorandum opinion of the Tax Court in the 1942 case, also related to issues other than those presently before this Court. In addition, in the 1942 case the Tax Court rendered a supplemental opinion (R. 216–219), reported at 20 T. C. 503, with respect to a matter not here pertinent.

JURISDICTION

The judgments of the Court of Appeals were entered on August 25, 1954 (R. 300, 301). A petition for rehearing (R. 302–310) was denied on September 27, 1954 (R. 310–311). The petition for a writ of certiorari was filed on November 22, 1954, and was granted on January 10, 1955, with respect only to questions 1 and 2 presented in the petition for certiorari (R. 311–312; 348 U. S. 911). The jurisdiction of this Court rests on 28 U. S. C., Sec. 1254.

QUESTIONS PRESENTED

The order granting certiorari (R. 311–312) limits review to questions 1 and 2 presented in the petition for certiorari which read as follows:

1. "Are transactions in commodity futures which are not 'true hedges' capital asset transactions and thus subject to the limitations of Section 117 of the Internal Revenue Code of 1939, or do the resulting gains and losses from such transactions give rise to ordinary income and ordinary deductions? (1940) (1942)"

2. "Are commodity futures contracts 'securities' and thus subject to the 'wash sales' provisions of Section 118 of the Internal Revenue Code of 1939? (1940) (1942)".

STATUTE INVOLVED

The relevant portions of Sections 112, 117, 118, 710, 711, 712, 713, 728, and 729 of the Internal

Revenue Code of 1939[2] are set forth in the Appendix, *infra*, pp. 59–67.

STATEMENT

In so far as material to the two questions before this Court, the facts, as found by the Tax Court in the two cases before it (R. 22–25, 202–206) and as stated by the court below (R. 293–295), are as follows:[3]

---

[2] Unless otherwise indicated, references to the Code will be to the Internal Revenue Code of 1939.

[3] In the 1940 case, the Tax Court decided only the second question, against the taxpayer—it being unnecessary for it to pass upon the first question, because the taxpayer could not, as a matter of computation, prevail in that case unless both questions were resolved in its favor (R. 26–29). In the 1942 case, the Tax Court did decide both questions, against the taxpayer, and it also passed upon several other matters not here material (R. 211–215, 216–219).

The Tax Court's findings of fact in the first case (R. 22–25) were based upon a stipulation of facts (R. 31–34) and accompanying exhibits (R. 35–39), and certain testimony (R. 49–94) and additional exhibits (R. 95–152) adduced at the hearing. Subsequently, in the second case, the parties submitted a new stipulation of facts and exhibits (R. 220–228, 230–236), which, insofar as material here, supplemented the information previously submitted and provided (R. 226) that the record in the first case be considered as evidence in the second case. The testimony in the second case (R. 248–263) did not relate to the two questions presently here.

Our recital of the facts here generally follows the findings in the second case (R. 202–206), with occasional reference to the findings in the first case and other parts of the record, as indicated. There was no significant change in the taxpayer's method of doing business between the years 1940 and 1942 (R. 206).

The taxpayer, a New Jersey corporation with its principal office in New York City, is engaged in the manufacture and sale of corn products, including starches, sugar, oils, and feeds. The principal product obtained by the taxpayer from raw corn is starch. Cerelose, one of its major products, is a refined sugar derived from starch which competes with cane and beet sugar. Its plants have a daily grind capacity of 170,000 bushels and a raw corn storage capacity of some 2,300,000 bushels, somewhat less than a three weeks' supply.[4] Between the years 1938 and 1942, its purchases of raw corn ranged from some 35,000,000 to some 60,000,000 bushels annually.[5] (R. 202–203.)

The taxpayer's sales policy has been in general, with certain exceptions, to contract for shipment within 30 days at specified prices, but giving the customer the benefit of market price at the time of delivery if lower. Also, it has been the taxpayer's practice to cancel any unfilled portion of an order at a customer's request. (R. 203.)

Among the exceptions or variations in the taxpayer's general sales policy were contracts with three other companies, respectively requiring the taxpayer to furnish, for periods ranging from 10

[4] Similar conditions existed in 1940 and in prior years (R. 23)—except that the daily grind capacity was 147,700 bushels in 1940 (R. 23, 33).

[5] The monthly and annual totals for those purchases are set forth in Exhibit 2–B to the stipulation of facts in the 1942 case (R. 231).

to 15 years, large quantities of starch or feed, either at a guaranteed price, or upon a price formula dependent on a number of factors including the price of corn and labor. Also, in January 1940, the taxpayer invited all buyers to submit orders for Cerelose for delivery as late as in the month of June, at the lower of the January 15 price or market on date of delivery, with cancellations permitted, and on that occasion the taxpayer sold about 2,000,000 bags of Cerelose. Also, members of the canning industry on the Pacific Coast have been permitted to call on the taxpayer for Cerelose for delivery in more than 30 days, with price guarantees and allowance for cancellations. (R. 203–204.)

For a number of years, it was the taxpayer's practice to purchase and sell corn futures contracts through members of a commodity exchange. A corn future is a contract calling for the delivery at a stated time, within 11 months or less, of 5,000 bushels of corn or some multiple thereof, of a stated quality, at a stated price. (R. 204.) The party contracting to furnish the corn has the option of delivering the corn on any day during the month in which the contract matures, or of furnishing a different grade, with an appropriate price adjustment. The buyer furnishes his broker with "margin", or a percentage of the contract price, until delivery is taken or the contract is sold, at which time final settlement is made. The

contracts are freely dealt in on the commodity exchange. (R. 23.)

The taxpayer engaged in futures transactions "as a part of its corn buying program," and "as the most economical method of obtaining an adequate supply of raw corn" in view of its limited storage facilities and the expense of increasing them sufficiently to meet its needs.[6] It bought futures when the price was advantageously low, beginning its buying each year at harvest time, and usually selling most of its futures in the early summer if it then appeared that there would be no corn shortage and no great danger of higher prices—while, if the latter occurred, it gradually sold its futures as it bought for grinding. The taxpayer took delivery on some contracts.[6] (R. 204.)

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[6] As shown by monthly figures in Exhibit 4-D in the 1942 case, the futures contracts purchased by the taxpayer during the years 1938 through 1942 on which it took delivery aggregated 4,975,000, 2,865,000, 250,000, 2,175,000, and 4,460,000 bushels, respectively. (R. 234–235.)

During the same years, the taxpayer bought futures contracts which were later sold aggregating 19,675,000, 14,470,000, 8,125,000, 4,115,000, and 8,675,000 bushels, respectively, as appears in Exhibit 3-C to the 1942 stipulation. (R. 232–233.)

The futures contracts sold by the taxpayer during each of these years amounted to 17,400,000, 14,180,000, 14,595,000, 2,545,000, and 5,695,000 bushels, respectively. (Ex. 5-E, R. 236.)

A detailed weekly analysis of stock on hand and unfilled orders, as to Cerelose and feed, respectively, during the period 1938 through 1942, appears in Joint Exhibit 6-F (R. 95–99, 265–269) and Joint Exhibit 7-G (R. 100–101, 270–271).

The futures contracts were not subject to depreciation and were not included in inventory—the taxpayer's raw corn inventory being affected only when delivery was taken under a futures contract. Profits or losses on futures were shown in a "Corn Miscellaneous" account, the net gain or loss for each year being debited or credited to cost of sales and treated as a reduction of or addition to cost of goods sold. (R. 204.)

High corn costs following droughts in 1934 and 1936 had resulted in losses on Cerelose sales by the taxpayer in 1937 and, to avoid or minimize similar losses, the taxpayer increased its buying of futures so as to have corn available at prices permitting competitive selling of Cerelose with beet and cane sugars—but it never reached its goal of a "long" position of 12,000,000 bushels in futures. (R. 23–24.) The outbreak of World War II in 1939 raised the price of cane and beet sugars to such an extent that the taxpayer no longer needed futures to assist it in successful competitive selling of Cerelose. At the beginning of 1940, it owned futures for over 8,000,000 bushels, but beginning about June, there being no indications of a shortage in crops in that year (R. 52), that "long" position was reduced, so that by the end of the year the taxpayer had only about 1,400,000 bushels in futures. (R. 24.)

In late 1939 and early 1940 the taxpayer had maintained a "long" position in futures of some seven to eight million bushels. In 1940, the Com-

modity Exchange Authority formally charged the taxpayer with speculating in grain, upon the ground that it had a "long" position exceeding by more than two million bushels the amount required for hedging. At a hearing, the taxpayer contended that its futures were not in excess of its needs and that its futures holdings were necessary to cover the products it expected to market over a period of 15 to 18 months. In demonstrating its needs, the taxpayer submitted evidence as to its unfilled orders, its sales commitments, including its long term contracts, and the estimated number of bushels required to meet such commitments. The taxpayer also relied upon the weekly and daily reports it had filed with the Authority giving information as to its position with respect to grain futures. In those reports, the taxpayer had included, among other matters, detailed information as to its transactions in grain, and its purchase and sales commitments for grain or grain products, and had stated that its futures were classifiable in character as hedging, rather than as speculative transactions. The taxpayer was upheld in its contentions in the proceedings before the Authority, and the action was dismissed.[7] (R. 204–205.)

[7] As the taxpayer points out (Br. 18–19, 29, 42), there has since been a similar proceeding against it, decided in December 1954. *In re Corn Products Refining Co.*, 13 Agric. Dec. 1117. There, the taxpayer was charged with excessive trading and holdings in corn futures in 1952. The proceeding is now pending, on appeal by the taxpayer, before the Second

From its purchases and sales of corn futures, the taxpayer had a net profit of $680,587.39 in 1940 (R. 24), and a net loss of $109,969.38 in 1942 (R. 206).[8]

During 1942, the taxpayer had gross sales of more than $131,000,000 and gross profits therefrom of more than $35,000,000.[9] Its opening and closing inventories for 1942 (inclusive of raw corn and processed products, valued at the lower of cost or market) were approximately $7,650,000 and $5,900,000, respectively.[10] (R. 206.)

The taxpayer's purchases of corn futures did not constitute speculative transactions for profit, but were consummated in order to obtain business protection and to insure the profitable conduct of its business (R. 206).

Circuit, *sub nom. Corn Products Refining Co.* v. *Benson, Secretary of Agriculture.*

[8] The profit or loss figures from futures for all years 1932 through 1942 were stipulated (R. 221). For the years 1936 through 1939 (its "base period" years—i. e., the years upon the basis of the income for which its excess profits taxes for the taxable year 1940 and 1942 are determined), the taxpayer had a net loss of $165,532.27 for 1936; a net gain of $590,339.35 for 1937; and net losses of $815,462.57 and $424,437.54 for 1938 and 1939, respectively.

[9] The corresponding figures for 1940 gross sales and gross profit therefrom were $55,000,000 and $18,000,000, respectively (R. 117).

[10] The corresponding figures for opening and closing inventories for 1940—similarly including raw corn and processed products (R. 81)—were some $4,988,000 and $4,800,000, respectively (R. 123).

The parties stipulated, for each of the taxable years (1940 and 1942), the separate gain or loss to the taxpayer from the sale of futures held for not more than 6 months and of those held more than 6 months, as computed both with and without the application of Section 118 of the Code [11] (R. 205–206).

Upon the basis of the foregoing findings, the Tax Court on these two issues held, contrary to the taxpayer's contentions, (1) that the taxpayer's gains and losses from its futures transactions are to be treated as resulting in increases or decreases in ordinary income, and not as capital gains and losses within Section 117 (R. 211–212); and (2) that the taxpayer's futures transactions are not within the wash sales provisions

[11] The stipulation shows that the taxpayer, by the application of Section 118, for 1940 would arrive at capital gains of $62,328.10 and capital losses of $202,662.60, instead of the net profit of $680,587.39 (R. 32–33; see also R. 27). Similarly, for 1939, the last year of its "base period," the taxpayer by the use of Section 118 would arrive at losses aggregating $244,550.03, instead of the net loss of $424,437.54; and for 1942 the taxpayer would arrive at capital gains totaling $75,769.38, instead of a net loss of $109,969.38 (R. 222–224). The table (Ex. 1–A, R. 230) submitted with the stipulation contains a detailed analysis of the effect, on taxpayer's theory, of the application of Section 118 to futures tradings for all of the years 1936 through 1942, showing specifically (under column "15") the total amount of the claimed "Wash Losses," in net result, for each of the years as follows (in round figures): for 1936, $227,000; for 1937, $3,300; for 1938, $1,177,000; for 1939, $1,978,000; for 1940, $520,000; for 1941, $45,000; and for 1942, $261,000.

of Section 118 (R. 26, 27–30, 212). The Court of Appeals unanimously affirmed (R. 293–298).

SUMMARY OF ARGUMENT

I

This case involves two questions, the second of which will be reached only if this Court reverses the court below, and holds, contrary to our contentions on the first question, that the gains and losses from taxpayer's futures transactions qualify for capital asset treatment under the Internal Revenue Code.

A. In general, under the Code the annual profits derived from the ordinary carrying on of a trade or business are taxed as ordinary income. Preferential treatment is, however, accorded by Section 117 to the results of dealings in property called capital assets, that are not the normal, direct source of business profits. The definition of a capital asset in Section 117 embodies an unusual draftsman's technique—the definition is specific only in stating what is *not* a capital asset. Taxpayer argues that because futures contracts do not fall strictly within the exclusions from Section 117 they must be held to be capital assets notwithstanding that they were employed, as held by both lower courts, as an integral part of the day-to-day operations of taxpayer's manufacturing business.

Taxpayer's approach ignores the settled rule that the scope of the preferential capital gains

provisions of the Code is to be strictly construed. Thus in *Burnet* v. *Harmel*, 287 U. S. 103, 106, one of the first cases to reach this Court following the inclusion of capital gains provisions in the income tax law, the Court indicated that the new provisions were to be strictly construed to effect the congressional purpose of relieving the taxpayer from the "excessive tax burdens on gains resulting from a conversion of capital investments" which it noted would often have accrued "over long periods of time." A necessary corollary of the rule that the capital asset definition of Section 117 is to be narrowly applied is that the exclusions from the capital asset definition shall be broadly applied so as not to frustrate the congressional purpose of limiting the preferential treatment to property in the nature of investments, not employed as an integral part of the day-to-day income producing activity of the taxpayer. Numerous decisions of the lower courts illustrate the application of these rules to varying fact situations. In none of these cases did the courts permit the receipts in question to qualify for capital gains treatment where to do so "would have tended to defeat rather than further the purpose of the Act." *Burnet* v. *Harmel*, 287 U. S. 103, 108.

In harmony with this approach to the capital gains provisions, it has long been the administrative and judicial construction of the statute

to regard hedging transactions as resulting in ordinary business profits or expenses, and not in capital gains or losses. Since hedging transactions are generally regarded as a form of insurance, it was a sensible view of the statute—subsequently recognized and concurred in by Congress—to treat the costs of hedging activities as a normal operating expense or as an inventory cost, and to treat the profits from such activities as normal operating profits.

Both of the lower courts concluded, on the basis of the record facts, that the taxpayer used futures transactions as an integral part of its manufacturing business and they both concluded, quite properly, that the results of those transactions, like the results of true hedging operations, must be reflected as ordinary income and deductions—not as capital gains or losses.

B. The taxpayer's transactions in corn futures served a twin business purpose in its manufacture of corn products. It used its futures transactions as a guaranty of a source of supply, thus compensating for its own limited storage capacity and limited inventory of raw corn. It also used futures to protect its manufacturing profit and the competitive position of its products against increases in the price of corn. While the taxpayer did not have protection against price declines as well, as it could have had if it had sold its products at fixed prices, that is unimportant to the tax

result. The important thing is that it did use futures to shift the risk of increases in price, and that was the contingency which it feared more than price declines.

The fact that taxpayer had partial rather than complete protection against price changes in raw corn has even less significance in view of the fact that it also used its futures transactions to guarantee it a supply of corn. Under these circumstances, the courts below were correct in holding that the costs of taxpayer's futures transactions were an operating expense of its business and were not capital losses, and that, to the extent that the futures transactions resulted in profits, they were operating profits of the business rather than capital gains.

The taxpayer makes several factual contentions in an effort to dispute the conclusions of the lower courts that its futures transactions formed an integral part of its business operations and it asserts, rather, that it dealt in corn futures as an independent "capitalist". But these contentions are contradicted by the record facts, including the testimony of the taxpayer's own witnesses, and by the permissible factual conclusions drawn by both lower courts. In this respect the decision below constitutes little more than the resolution of a factual issue adversely to taxpayer. Taxpayer's assertions in its brief that it bought and sold futures as an independent "capitalist" separate and apart from its manufacturing business, and

its claim to be taxed on that basis, finds no support in the record.

II

If this Court agrees with the lower courts on point I, namely, that taxpayer's futures transactions resulted in ordinary income and ordinary deductions, rather than in capital gains and losses, there will be no need to consider the further issue raised by the taxpayer, namely, whether its losses from futures transactions are subject to the "wash" loss provisions of Code Section 118. If, however, it should be held that the taxpayer had capital gains and losses from these transactions, then we contend that the losses are not subject to the provisions of Section 118.

A. Section 118 prohibits the deduction of losses sustained from the sale of securities only when the taxpayer, within a limited time, acquires identical or "substantially identical" stock or securities. Contracts for the future delivery of commodities are not substantially identical, one with another, even if they could be regarded as securities. The significance of differences in maturity of different futures contracts is, of itself, so substantial as to require the conclusion, concurred in by both courts below, that the taxpayer was not engaging in "wash sales" (a practice unlawful under the Commodity Exchange Act) because it was not buying and selling "substantially identical" securities.

B. Section 118 is not applicable for a further, independent reason. That section is concerned with wash losses from sales of "shares of stock or securities." Contracts for the future delivery of commodities are neither "shares of stock" nor "securities." The purpose of the section was to prevent the deduction of fictitious losses, an evil not present in the case of dealings in commodity futures, which are contracts for short periods of time. The normal meaning of the term "securities", the congressional use of that term in other sections of the Code, and the fact that Congress has always referred to commodity futures specifically when it intended to describe such contracts, give force to the conclusion of the lower courts that commodity futures are not securities within the meaning of Section 118.

ARGUMENT

I

TAXPAYER'S CORN FUTURES TRANSACTIONS GAVE RISE TO ORDINARY INCOME AND ORDINARY DEDUCTIONS

A. THE INTERNAL REVENUE CODE TREATS AS ORDINARY INCOME TRANSACTIONS THE ANNUAL GAINS AND LOSSES FROM THE OPERATION OF A MANUFACTURING BUSINESS

This case involves the proper tax treatment, i. e., as ordinary gains and losses or as capital gains and losses, of certain transactions in commodity futures. Both courts below held that the taxpayer had engaged in these transactions as an integral part of its manufacturing business for

the twin purposes of obtaining protection against increases in prices of its basic raw material and of assuring itself a sufficient supply thereof to meet anticipated future requirements. Because these transactions were carried on to stabilize inventory costs and thus protect profit, both courts concluded that the results thereof were not entitled to capital gain or capital loss treatment under Section 117 of the Internal Revenue Code of 1939 (*infra*, pp. 59–60). In its returns for the years here involved (and for prior years), taxpayer accounted for the results of its futures transactions, as we think it should, as ordinary profits and losses (R. 24, 211, 222). It is our position that that treatment was correct,[12] and that accordingly the decision below should be affirmed.

The case presents a question as to the proper construction to be given to Code Section 117 which provides that gains from transactions in certain property, with important exceptions, should be taxed at preferential rates as capital gains, and which imposes restrictions on the deduction of losses therefrom as capital losses. In general, under the Internal Revenue Code, the annual profits derived from the carrying on of a trade or business are taxed as ordinary income. The tax treatment of business profits is the same as that given to the normal classes of in-

[12] The changed basis of accounting for the results of its futures transactions which taxpayer now seeks, if taxpayer prevails on both issues herein, will allegedly have tax consequences aggregating at least one and a half million dollars.

come in the economic world, *e. g.*, compensation for personal services, dividend income, rents, royalties, etc.; and losses suffered in the conduct of a business are treated as ordinary losses, fully deductible against income. Preferential treatment is, however, accorded by Section 117, to the results of dealings or transactions in property which are not the normal source of business income, and there are strict limitations on the deduction of losses from transactions in such property.

The definition of a capital asset in Section 117 embodies an unusual draftsman's technique—the definition is specific only in stating what is *not* a capital asset. The congressional purpose in granting special tax preference to gains from, and of limiting the deductions of losses on, the sale or exchange of capital assets must be gleaned from the exceptions enumerated in the statute, *i. e.*, from the kinds of gains or losses which do not qualify for special consideration.

That Congress did not intend that the net profit or loss resulting from the normal every-day operation of a business should qualify for the special treatment accorded to capital gains or losses is fully apparent from the exceptions stated in Section 117, which include (1) stock in trade, (2) inventory, (3) property held for sale to customers in the ordinary course of a trade or business, and (4) depreciable property used in the trade or business.

The taxpayer's claim to capital asset treatment of its futures transactions rests on a simple syllogism: its futures contracts were "property"; they were not its stock in trade; they did not (strictly) form part of its inventory; they were not being held for sale to customers and they were not subject to depreciation. With these statements we agree. But we disagree with the conclusion that taxpayer draws, namely, that since the futures contracts do not come within the precise words of the enumerated exceptions, they must be classified as capital assets. (Br. 13–15, 32–33, 36–37.)

This approach is fallacious in that it ignores the settled rule that the scope of the preferential capital gains provisions of the Code shall be strictly construed. Moreover, it ignores the role which commodity futures played in the day-to-day conduct of taxpayer's manufacturing business (see pp. 31–41, *infra*); in no real sense were these transactions in capital assets, and to treat them as such for tax purposes would do violence to the basic purpose and scope of Section 117.

In *Burnet* v. *Harmel*, 287 U. S. 103, one of the first cases to reach the Court following the inclusion of special capital gains provisions in the income tax law, this Court indicated that their scope was to be strictly construed. In that case the taxpayer contended that bonus payments received in consideration of the execution of oil

and gas leases represented proceeds from the sale of capital assets (*i. e.*, sale of the oil in place) and were entitled to capital gains treatment. In dealing with this contention, the Court first looked to the purpose of the Act (*id.* at 106):

> Before the Act of 1921, gains realized from the sale of property were taxed at the same rates as other income, with the result that capital gains, often accruing over long periods of time, were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provisions of the 1921 revenue act for taxing capital gains at a lower rate * * * were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.

The Court then noted that "the taxation of the receipts of the lessor as income does not ordinarily produce the kind of hardship aimed at by the capital gains provision of the taxing act", and that, moreover, to regard the transaction as a sale within the meaning of Section 208 of the Revenue Act of 1924, c. 234, 43 Stat. 262, would ignore the fact that the extraction of minerals had long been regarded as resembling "a manufacturing business carried on by the use of the soil, to which the passing of title of the minerals is but an incident" (*id.* at 106, 107). The Court concluded

that the payments were not entitled to capital gains treatment; such a result "would have tended to defeat rather than further the purpose of the Act" (*id.* at 108).

This approach has two aspects, in view of the form of Section 117. On the one hand, as this Court indicated in *Burnet* v. *Harmel,* 287 U. S. 103, the usual rule that statutory exceptions from income tax under the provisions of the Internal Revenue Code are to be strictly construed, requires that the capital asset definition be narrowly applied. See *Ogle* v. *Helvering,* 77 F. 2d 338, 339 (C. A. 2d); *Sloane* v. *Commissioner,* 188 F. 2d 254 (C. A. 6th). As a necessary corollary, the exclusions from the capital asset concept of Section 117 must be broadly applied to effectuate the basic Congressional purpose.

Thus, this Court and the lower courts have consistently refused, in a wide variety of circumstances, to treat as capital gain, or as a return of a capital investment, receipts which are not the kind of gain for which the statute intended preferential treatment. In many situations capital gain or loss has been denied, even though, superficially, the transactions qualified under the literal language of the capital-gains provisions. See *e. g., Kieselbach* v. *Commissioner,* 317 U. S. 399 (portion of lump-sum condemnation award which represented compensation for delay in payment taxed as ordinary income); *Hort* v. *Commissioner,* 313 U. S. 28 (lump sum received for can-

cellation of lease regarded as a substitute for rent, taxable as ordinary income, rather than as proceeds from sale of lease); *Helvering* v. *Smith*, 90 F. 2d 590 (C. A. 2d), and *Doyle* v. *Commissioner*, 102 F. 2d 86 (C. A. 4th) (sale of right to receive legal fee for services rendered, taxed as ordinary income rather than as sale of capital asset); *Rhodes' Estate* v. *Commissioner*, 131 F. 2d 50 (C. A. 6th) (sale of right to receive previously declared dividend held not taxable as sale of capital asset); *Fisher* v. *Commissioner*, 209 F. 2d 513 (C. A. 6th), certiorari denied, 347 U. S. 1014 (sale of past-due interest taxable as ordinary income); *Shuster* v. *Helvering*, 121 F. 2d 643 (C. A. 2d) (payment received on cancellation of employment contract taxable as ordinary income).

Significant, too, are decisions refusing capital gain or loss treatment to property which served a purpose directly related to the earning of normal business profits, even though the property did not come within the literal language of the statutory exceptions to the capital asset definition. *Commissioner* v. *Bagley & Sewall Co.*, 221 F. 2d 944, 947 (C. A. 2d) (loss on United States bonds purchased in order to meet contract requirement that they be posted as security for performance of the contract and sold when released in accordance with the contract, held deductible as ordinary loss). See also, *Commissioner* v. *Western Wine & Liquor Co.*, 18 T. C. 1090, appeal dismissed, 205 F. 2d 420 (C. A. 8th);

Clark v. *Commissioner*, 19 T. C. 48, appeal dismissed June 18, 1953 (C. A. 9th), and *Hogg* v. *Allen*, 105 F. Supp. 12 (M. D. Ga.), affirmed on this point, *sub nom. Edwards* v. *Hogg*, 214 F. 2d 640 (C. A. 5th) (taxpayers who were in business of buying and selling whiskey and who purchased shares of stock in distilling companies in order to have opportunity of purchasing, on favorable terms, whiskey which was in short supply did not suffer capital loss on later disposition of the shares of stock, the loss being held to constitute a part of the cost of acquiring the inventory of whiskey); *Helvering* v. *Community Bond & Mortgage Corp.*, 74 F. 2d 727 (C. A. 2d) (loss on stock of another corporation purchased in order to dissolve it, thus cancelling an unprofitable contract with such corporation, held deductible as a business expense).

The tax treatment of gains and losses from hedging transactions in commodity futures [13] provides a further illustration of the proper construction of Section 117. In general, hedging transactions are entered into by manufacturers "to insure themselves against loss by unfavorable changes in price at the time of actual delivery of what they have to sell or buy in their business." See *United*

[13] A commodity future has been defined as "an agreement to buy or sell, in accordance with law and the rules of an exchange, a definite quantity of a commodity at an agreed price at a future date, being entered into for the purpose of speculating on or hedging against price changes." Hoffman, *Future Trading* 118 (1932). (See R. 204.)

States v. *Coffee Exchange*, 263 U. S. 611, 619. See further, *Browne* v. *Thorn*, 260 U. S. 137, 139–140.

The rules of the Commodity Exchange of New York broadly define a hedge transaction as a purchase or sale of a futures contract "executed for the purpose of minimizing a price risk or facilitating a customary or normal conduct of business" (R. 93). See also *In re Corn Products Refining Co.*, 13 Agric. Dec. 1117, 1131. "True" hedging operations are those where the manufacturer or processor, by matching forward business commitments with futures transactions on the commodity market concerned, shifts the entire, or virtually the entire, risk of price fluctuations in the commodity in question to others. Hoffman, *Future Trading* 4, 142–144 (1932). Hedging thus is a form of insurance of normal operating profits against the risks consequent upon fluctuations in the market price of the product in which the business deals, or the materials used by that business in its manufacturing operations. See *United States* v. *Coffee Exchange*, 263 U. S. 611, 619; *Board of Trade* v. *Christie Grain and Stock Co.*, 198 U. S. 236, 249. See also, Hoffman, *supra*, pp. 4, 142, 381–383.

The question as to the appropriate tax treatment of gains and losses from hedging transactions first arose under the Revenue Act of 1934, c. 277, 48 Stat. 680. Prior thereto, capital assets were limited by definition to assets held more than

two years. Since under the rules of various commodity exchanges, futures contracts were required in all cases to be closed out in periods shorter than two years, futures contracts were excluded from consideration as capital assets.

The Revenue Act of 1934, Sec. 117 (b), eliminated the two-year limitation from the definition of capital assets. Thereafter the Treasury Department in 1936 issued G. C. M. 17322, XV-2 Cum. Bull. 151, which distinguished between commodity futures transactions which were speculative and those which were engaged in for hedging purposes. The former, it said, fell within the scope of the capital assets provisions of the 1934 Act. But in harmony with *Burnet* v. *Harmel*, 287 U. S. 103, and cases like those cited at pp. 21-23, *supra*, which had looked to the underlying purpose of the capital gains provision, the ruling provided that since "hedging transactions are essentially to be regarded as insurance rather than a dealing in capital assets," gains and losses therefrom should be treated as ordinary business gains and losses (XV-2 Cum. Bull. at 155). The G. C. M. explained (*id.* at 152):

> Such hedges, which eliminate speculative risks due to fluctuations in the market price of cotton and thereby tend to assure ordinary operating profits, are common trade practices and are generally regarded as a form of insurance (the only kind available as protection against such risks) necessary

> to conservative business operation. Where futures contracts are entered into only to insure against the above-mentioned risks inherent in the taxpayer's business, the hedging operations should be recognized as a legitimate form of business insurance. As such, the cost thereof (which includes losses sustained therein) is an ordinary and necessary expense deductible under section 23 (a) of the Revenue Act of 1934 and corresponding provisions of prior Revenue Acts. . .

The contrary view, as this Court had stated in *Burnet* v. *Harmel*, 287 U. S. 103, 108, "would have tended to defeat rather than further the purpose of the Act."

The ruling has since been applied administratively and judicially. *Grote* v. *Commissioner*, 41 B. T. A. 247; *Battelle* v. *Commissioner*, 47 B. T. A. 117; *Stewart Silk Corp.* v. *Commissioner*, 9 T. C. 174. See also *Commissioner* v. *Farmers & G. C. Oil Co.*, 120 F. 2d 772 (C. A. 5th), certiorari denied, 314 U. S. 683; *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33, 35 (C. A. 6th), rehearing denied, 148 F. 2d 208; G. C. M. 18383, 1937–2 Cum. Bull. 244; I. T. 3137, 1937–2 Cum. Bull. 164; and G. C. M. 18658, 1937–2 Cum. Bull. 77. *Cf. Tennessee Egg Co.* v. *Commissioner*, 47 B. T. A. 558; *Commissioner* v. *Covington*, 120 F. 2d 768 (C. A. 5th), certiorari denied, 315 U. S. 822; *Estate of Makransky* v. *Commissioner*, 5 T. C. 397, affirmed *per curiam*, 154 F. 2d 59 (C. A. 3d). Cf. further, *Commis-*

sioner v. Banfield, 122 F. 2d 1017, 1019–1020 (C. A. 9th).

Recognizing that the construction of Section 117 for which it contends is opposed to the established rule applicable to hedging transactions, taxpayer now seeks to attack the validity of that rule, even as it applies to "true" hedging operations (see Br. 18). It is led to do this because futures contracts do not, in the strict sense of the words, represent stock in trade, inventory, property held for sale to customers, or depreciable property used in a trade or business, i. e., strictly speaking, as urged by taxpayer, they do not fall within the broad categories of property excluded from the definition of a capital asset. But in this attack, taxpayer must fail. As this Court has indicated, the capital gains provisions must be read in the light of their purpose and in the context of the pattern of the income tax law which taxes ordinary income at full rates and grants exceptional treatment to capital gains and losses. So read, it becomes evident that Congress has made it as clear as the limitations of language permit (short of a detailed enumeration of every conceivable kind of transaction which might be found in every conceivable type of business) that profits and losses derived from the normal operation of a business are not to receive the special tax considerations reserved for what, generally, may be described as investments. "The purpose is to protect 'investment property' as distinguished

from 'stock in trade,' or property bought and sold for a profit." *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263, 266–267 (C. A. 9th). Accord: *Kenan* v. *Commissioner*, 114 F. 2d 217, 220 (C. A. 2d); *Commissioner* v. *Shapiro*, 125 F. 2d 532, 535–536 (C. A. 6th); *Rieger* v. *Commissioner*, 139 F. 2d 618, 621 (C. A. 6th); *Watson* v. *Commissioner*, 197 F. 2d 56, 58 (C. A. 9th), affirmed, 345 U. S. 544.

The propriety of excluding from capital gains treatment gains and losses from hedging transactions has never before been questioned over the period of almost twenty years during which G. C. M. 17322, *supra*, has been administratively applied.[14] On the contrary, the courts have uniformly accepted the proposition that hedging transactions did not come within the capital asset concept of the statute. See cases cited, pp. 26–27, *supra*. In the concrete circumstances of particular cases there have been controversies concerning the proper application of the rule, and a limited

[14] The propriety of taking into account, in the determination of taxable income, the results of "hedges" in commodity futures transactions, in effect treating them as items affecting inventory or as inventory adjustments, had previously been recognized and has been consistently adhered to in the administrative practice, in the case of dealers in grain, cotton, and other commodities, and millers. See A. R. M. 135, 5 Cum. Bull. 67 (1921) (distinguishing A. R. M. 100, 3 Cum. Bull. 66 (1920)); I. T. 1166, I–1 Cum. Bull. 52 (1922); S. R. 5084, IV–2 Cum. Bull. 120 (1925); S. M. 5693, V–2 Cum. Bull. 20 (1926); I. T. 3123, 1937–2 Cum. Bull. 114.

amount of litigation has resulted; but no court has ever questioned the conclusion that at least "true" hedging transactions are not to be accounted for as capital gains or losses.

Congress, moreover, has recognized that Section 117 does not apply to hedging transactions. Thus Section 1233 (a) of the 1954 Code provides that gain or loss from "the short sale of property, *other than a hedging transaction in commodity futures*" is to be treated as gain or loss from the sale of a capital asset to the extent "that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of the taxpayer." [Italics supplied.] The committee reports of both houses of Congress, in connection with the enactment of that provision (H. Rep. No. 1337, 83d Cong., 2d Sess., p. A278, and S. Rep. No. 1622, 83d Cong., 2d Sess., p. 437), state:

> Under existing law bona fide hedging transactions do not result in capital gains or losses. This result is based upon case law and regulations. To continue this result hedging transactions in commodity futures have been specifically excepted from the operation of this subsection.

We thus have the adoption of an administrative construction in 1936, under the first statute which posed the problem (the Revenue Act of 1934), followed by repeated reenactments of the same capital assets provision in the Revenue Acts of 1936, c. 690, 49 Stat. 1648; 1938, c. 289, 52 Stat.

447, and in the 1939 Code. More recently, that administrative construction has received legislative recognition in the 1954 Code. This administrative construction, which has been followed by the Tax Court and other courts, must, upon settled rules, be regarded as having received legislative sanction. See *Burnet* v. *Harmel*, 287 U. S. 103, 108; *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 114–115; *National Lead Co.* v. *United States*, 252 U. S. 140, 146–147; *Commissioner* v. *Wheeler*, 324 U. S. 542, 547, fn. 10. Cf. *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426, 431–432. That construction should not be disturbed at this late date.

It is important to emphasize that, contrary to the taxpayer's argument (Br. 18), the tax treatment of hedges is not an "exception" to the statute to be invoked only where "true" hedges are involved. As we have shown and as the court below observed: "The tax treatment of hedges * * * is simply a recognition by the courts that property used in hedging transactions properly comes within the exclusions of the section [117 (a)]" (R. 296). This case, accordingly, does not turn upon the narrow, artificial question whether the taxpayer's futures transactions come within the precise terms of a hypothetical "hedging exception." It depends, rather, on whether the profits and losses resulting from taxpayer's hedging transactions should be held to fall within the area of operating profits derived from carry-

ing on a business, and thus outside the scope of the preferential capital-gains-or-loss provisions of the statute.

It is, therefore, essential to examine the nature of taxpayer's transactions in commodity futures in the context of the over-all operation of its manufacturing business.

B. TAXPAYER'S TRANSACTIONS IN CORN FUTURES, AS HELD BY THE TWO COURTS BELOW, FORMED AN INTEGRAL PART OF ITS MANUFACTURING BUSINESS

1. Taxpayer purchased corn futures to obtain business protection and to insure the profitable conduct of its business.

In its business taxpayer used large amounts of corn. Its grinding capacity was 170,000 bushels per day. The maximum amount of raw corn which it could store during the relevant periods was roughly 2,300,000 bushels, or only about three weeks' supply, so it decided to buy corn futures in order to insure a supply of and a stable price for the raw product. (R. 294.) Its holdings of corn futures over the period 1940–1942 never exceeded the equivalent of about three months' requirements, and over most of the period totaled far less than three months' requirements. (See chart 1, *infra*.) As the Tax Court found (R. 204, 206):

> Petitioner engaged in futures transactions as a part of its corn buying program and as the most economical method of obtaining an adequate supply of raw corn in view of its limited storage facilities

> and the expense of increasing those facilities sufficiently to take care of its needs. Purchases of futures were made when the price of corn was advantageously low. Petitioner took delivery of corn on some contracts, but it usually sold most of its futures in early summer if it then appeared that there would be no shortage of corn and no great danger of increased prices. If the crop was poor or there was danger of a price increase it sold its futures gradually as it bought corn for grinding. Petitioner would begin to acquire additional futures contracts at harvest time each year.
>
> * * * * * * *
>
> Petitioner's purchases of corn futures did not constitute speculative transactions for profit, but were consumated in order to obtain business protection and to insure the profitable conduct of its business.

Taxpayer does not directly attack these findings of fact, which were affirmed by the Court of Appeals (R. 294). Its argument turns rather on the contentions (a) that the futures transactions were not sufficiently related to its business operations so as to be accountable, like gains and losses on inventory, as ordinary profits and losses from the operation of the business, and (b) that its futures transactions should be regarded as though made by an independent "capitalist," separate and apart from its business operations (Br. 23–38). Each of these contentions does not survive analysis.

(a) Taxpayer's futures transactions formed an integral part of its manufacturing business. By purchasing contracts for future delivery of corn, taxpayer achieved two business objectives which were important to it as a large-scale manufacturer of corn products. It protected itself against future increases in the price of raw corn and thus protected its manufacturing profit and the competitive position of its products (R. 51, 52, 54, 206, 297), for its policy was to sell under contracts which provided that the price shall be contract or market, whichever is lower. It also, to the extent of its holdings, assured itself of a future supply of corn which would enable it to maintain the scheduled volume of its manufacturing operations. In view of its limited storage capacity, it was cheaper to purchase futures than corn, since storage charges would have to be paid (R. 50–51). These considerations form the foundation of our position that taxpayers' futures transactions were, as held by the courts below, entered into as an integral part of its manufacturing operations "as the most economical method of obtaining an adequate supply of raw corn in view of its limited storage facilities" (R. 204), and "to stabilize inventory costs and thus protect profit" (R. 297).[15]

[15] *Cf. In re Corn Products Refining Co.*, 13 Agric. Dec. 1117, 1125: "[Taxpayer's] trading in futures is not done for the purpose of speculating in price differences, but in good faith for the purpose of offsetting risks and reducing costs of its business. It regards such trading as proper and legitimate hedging."

Taxpayer, of course, did not have the complete protection against changes in the market price of its principal raw material of the sort which is available to manufacturers whose operations yield to the protection afforded by what is known as a "true" hedge. Such complete protection is available, for example, to processors who contract to sell manufactured products for future delivery at fixed prices and at the same time purchase an equivalent quantity of the raw material concerned for delivery at the same future date; if the price of the raw material rises, a profit is made on the futures contract which offsets the increased cost of the raw material, and, conversely, if the price of the raw material falls, a loss is realized on the futures contract which is offset by the lower cost of the raw material. In either case, the manufacturing profit is assured.

Such complete protection was not available to taxpayer, however, because it chose for business reasons sufficient to itself to sell its products under contracts in which the price to the buyer was fixed at contract price or market price, whichever was lower. The customer thus was assured the benefit of any decline in the market price, and was protected by its contract against any increase in the market price. On the other hand, if the price of corn increased, taxpayer's entire manufacturing profit might be wiped out.

Further, as taxpayer made clear (R. 23–24, 51), a substantial increase in the price of corn could impair the competitive position of its products.

In these circumstances taxpayer attempted to obtain some protection for its business; it did this by shifting the risk of increased corn prices to speculators, through the instrumentality of the corn futures market. It could not, without changing its method of selling (guaranteeing against price decline), protect itself against a price decline of corn products. Thus, given its business methods and its competitive position, "It feared the possibility of a price rise more than that of a price decline" (Br. 30). Therefore, in its futures market dealings, taxpayer purchased a type of insurance to protect its manufacturing profit against its *principal* risk. It was only partial insurance, to be sure, but, given its method of doing business, that was the extent that insurance against price changes in corn was available to it.

There is of course no exact correspondence between taxpayer's purchases of futures and its orders on hand plus anticipated sales for delivery as of the maturity dates of its futures contracts. That is so because taxpayer's futures-buying program was a mixed operation. As the courts below found, it was as much a part of its corn-buying program as it was a device for protecting

itself against increases in the price of corn. Taxpayer purchased futures, in part, as the most economical method of obtaining an adequate supply of raw corn in view of its limited storage facilities (R. 204).[16] It entered the market when it deemed prices to be "advantageously low" (R. 204), and it reduced its holdings about June or July if there were no indications of a short crop of corn (R. 52; R. 24, 204). In other words it sold its futures after it was assured that there would be no sharp rise in the price of corn because of a poor harvest. Over the years, it took deliveries of a substantial amount of corn under its futures contracts as they matured.[17]

In additional instances, taxpayer undoubtedly sold futures about to mature at the same time as it bought spot corn. This might well have been to its advantage because it could control the grade of corn delivered on spot purchases and at the same time effect minor cost savings. See Hoffman, *Future Trading*, pp. 99–110, 266–267, 277–280, 306–313. See also R. 79.

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[16] Cf. Rich and Rippe, *Tax Aspects of Commodity Futures Transactions with a Business Purpose*, 2 Tax L. Rev. 541, 557, 559–560 (1947). The authors suggest that futures purchases which are resorted to by a manufacturer because of inadequate storage capacity should be treated for tax purposes as having the same effect as purchases of the commodity itself, even though they do not meet the technical definition of hedging.

[17] The annual totals of futures contracts under which the taxpayer took delivery are, in bushels: 1938, 4,975,000; 1939, 2,865,000; 1940, 250,000; 1941, 2,175,000; 1942, 4,460,000 (Ex. 4–D, R. 234–235).

The broad relationship between taxpayer's holdings of futures and its orders on hand is shown on our Chart 1 (*infra*, p. 68).[18] See also joint exhibit 7–G (R. 101, 271). It will be seen that there is a broad correspondence between futures owned and orders, particularly in 1940 and 1942, the years involved in this suit. Prior to 1940, it had embarked on a policy of maintaining a long position in corn considerably in excess of orders on hand to protect its manufacturing profits and the competitive position of its products, but the onset of war, with increases in price of competitive cane and beet sugar, together with the large 1939 crop, caused it in 1940 to liquidate this long position (R. 52, 54, 55). The "interference" (R. 52) which taxpayer had had from the Department of Agriculture under the Commodity Exchange Act (see pp. 44–45, *infra*) may also have had something to do with the reduction of its long position in 1940.

Further insight into the business problem which confronted taxpayer is gained by a study of Chart No. 2, which compares taxpayer's holdings in futures to the volume of commercial corn carry-overs in terminal storage. It will be seen that taxpayer reduced its holdings of futures in 1940 and that, in contrast to the previous year,

[18] Chart 1 is based on the figures used by taxpayer to construct its chart at page 9 of its brief. Taxpayer's chart is misleading. By pyramiding futures on top of stocks on top of storage capacity, taxpayer has made very difficult a comparison between futures owned and orders on hand, which is the relevant comparison.

there was in 1940 a large carry-over in terminal markets.

Much of the taxpayer's brief is devoted to a discussion as to why its transactions were not "true" hedges (see especially pp. 28–31). There is no dispute as to this. We agree that the transactions were not "true" hedges. But that is not the issue in this case. Taxpayer's discussion of the nature of its operations would be significant only if it showed that taxpayer's futures transactions were so divorced from its manufacturing operations as to qualify for capital-gains treatment under Section 117. We will analyze the five points made by taxpayer at pages 28–31 of its brief from this point of view.

(i) Taxpayer states that "At almost all times Petitioner had on hand sufficient corn and manufactured inventory (stocks) to meet all of its customers' orders," and that "the amount of orders which could at any time have been applied to offset futures was insignificant," and refers to its chart at page 9 of its brief (Br. 28, 7, 38). We question these statements. It can be seen from our chart 1 (*infra,* p. 68) that in eight of the twelve periods during the years 1940 to 1942 shown on the chart, taxpayer had orders on hand in excess of stocks and that in six of these periods taxpayer's orders were substantially in excess of its stocks on hand. But in any event this comparison has no controlling effect on our present

inquiry. The size of taxpayer's stocks would be contolling to the question whether *short* sales of futures are hedges (see p. 35, *supra*). But taxpayer made no such short sales. On the contrary, it acquired a long futures position, which is the appropriate hedge against forward sales of products.

(ii) Taxpayer states that the "time and amount of Petitioner's purchases of corn futures had no relationship to the time and amount of orders for the sale of its products," and again it refers to its chart (Br. 28–29). But when its chart is reconstructed so as to show the relevant comparisons (*infra*, p. 68), we think it shows quite plainly that there was a broad relationship between futures owned and orders, as taxpayer's witnesses testified. Thus its witness Hall, who at the times material was a vice president (R. 72), testified: "Whatever [futures] we had was what we needed for the scope of our business" (R. 73). Further, he testified (R. 76), with respect to 1940, that "we needed the corn we had." Similarly, testimony of record shows that in 1940, when taxpayer was involved in difficulties under the Commodity Exchange Act, it asserted that it was entitled to acquire futures contracts as a hedge against the products it "expected to market over a period of * * * fifteen or eighteen months" (R. 73), and, in successfully demonstrating its needs, it showed its "sales commitments," including its several long-term supply contracts, etc. (R. 76).

Taxpayer states in its brief: "Significantly at the time (July 1, 1941) when Petitioner had the largest amount of orders, its corn futures position was the smallest" (Br. 29). But as we have seen (*supra*, p. 37), taxpayer's witnesses explained that the liquidation of its long position in 1940 was due to the increases in price of competitive sugars which followed the outbreak of war abroad and the success of the 1939 crop. The reduction of its long position in response to these factors, then, contrary to taxpayer's intimations, illustrates the great extent to which the taxpayer in fact integrated futures purchases into its business operations to protect its manufacturing profits.

(iii) Taxpayer argues that since under its sales policy it "in actuality had no commitments for the sale of its products on which it could count," it had nothing to hedge (Br. 29). This would appear to be somewhat disingenuous. Taxpayer *on its part* was bound under its sale contracts, and it was for this reason that it found it in its business interest to hedge against increases in price. Naturally, customers who because of price advances found themselves with contracts to purchase corn products at prices below market prices would in the usual course of business take deliveries under those contracts. And in any event, in buying futures, the taxpayer must have relied on its experience as to cancellations. It may be noted that the Department of Agriculture found in another proceeding, as to 1952, that taxpayer on the

basis of past experience "forecasts what its sales will be for months ahead" with a small range of error. *In re Corn Products Refining Co.*, 13 Agric. Dec. 1117, 1125.[19]

(iv) We have already discussed taxpayer's argument that because of its sales policy it could protect itself only against increases in price and not against decreases in price (Br. 29–30) (see pp. 34–35, *supra*). The point is that taxpayer did protect itself against increases in price; under its method of doing business it could do no better. Taxpayer further argues that "price protection could have been obtained * * * only by sales of cane sugar futures" (Br. 29). But it is of no consequence to speculate as to what additional practices taxpayer might have resorted to in order more effectively to protect its business against market fluctuations; we are concerned only with what taxpayer did in fact do, and its relation to its manufacturing operations.

(b) Taxpayer's further contention (Br. 31) that it entered the market neither to hedge nor to speculate but as a "legitimate capitalist" is dealt with below.

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[19] We do not find record support for taxpayer's statement that "cancellations were frequent, unpredictable, and substantial" (Br. 29). It cites only one instance of a substantial cancellation (Br. 10; R. 69). But even if taxpayer's characterization is accurate, it is of no moment so long as it was able to forecast with some degree of accuracy its future sales.

2. Taxpayer did not deal in futures contracts as a speculator or independent "capitalist" separate and apart from its manufacturing business

Taxpayer is in a very difficult position in this proceeding. It cannot argue that it dealt in the futures market as a speculator, because that might increase its difficulties with the Department of Agriculture under the Commodity Exchange Act.[20] On the other hand, it cannot admit here that, as found by the courts below, it dealt in futures as a part of its corn-buying program and to stabilize inventory costs, because that would uphold the contention of the Government that the gains and losses on these transactions must, for tax purposes, be accounted for just like any other gains and losses in inventory operations. So it makes what amounts to an indirect attack on the findings of the courts below by suggesting that it dealt in futures during these years as a "legitimate capitalist" (Br. 21, 28, 30–31) and that these dealings were separate and apart from its manufacturing operations.

The label is unimportant. Even if descriptive of taxpayer's dealings in futures, which we doubt,[21]

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[20] See *In re Corn Products Refining Co.*, 13 Agric. Dec. 1117, appeal pending (C. A. 2d) *sub nom. Corn Products Refining Co.* v. *Benson.*

[21] In *United States* v. *Coffee Exchange*, 263 U. S. 611, 619, this Court divided those who deal in futures into three classes: (1) "those who use them to hedge"; (2) "legitimate capitalists who, exercising their judgment as to the conditions, purchase or sell for future delivery with a view to

the label would not serve to insulate these transactions from taxpayer's regular manufacturing operations, and give them a special, isolated status as capital assets. As we have seen, taxpayer purchased futures when it deemed the prices to be "advantageously low" (R. 204), took deliveries of very substantial amounts of corn under its futures contracts (R. 234–235), and sold others when it appeared certain that there would not be a poor crop (R. 24, 204). The fact that when it purchased any particular contract it did not know whether it would later sell the contract or take delivery under it would itself seem to distinguish taxpayer's operations from those of a speculator or independent "capitalist". Also, its officers emphatically testified that taxpayer did not speculate at any time (R. 43, 58, 60, 63), and that its purchases of futures were not in excess of its "needs" (R. 73, 76) "to protect the business from loss" (R. 63).

Taxpayer's present protestations, moreover, can hardly serve to detract from the force of the following findings of the Tax Court based on, among other things, testimony as to taxpayer's own representations to the Department of Agriculture in a pro-

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profit based on the law of supply and demand"; and (3) "gamblers or irresponsible speculators who buy or sell as upon the turn of a card." The second class would seem to fit informed speculators rather than manufacturers who, like taxpayer, purchase futures as a part of their inventory program and to protect themselves against increases in price.

ceeding which took place during the first taxable year (1940) involved in this suit (R. 204–205):

> During late 1939 and early 1940 petitioner maintained a long position in corn futures contracts of from 7,000,000 to 8,000,000 bushels. In 1940 the Commodity Exchange Authority formally charged petitioner with speculating in grain on the ground that it had a long position in excess by more than 2,000,000 bushels of the amount it required for hedging. At a hearing petitioner took the position that its futures were not in excess of its needs and that the contracts it held were necessary to cover the products which it expected to market over a period of 15 to 18 months. In demonstrating its needs petitioner submitted evidence as to its unfilled orders, its sales commitments, its contracts with the Huron Milling Company and the Keever Starch Company, and the estimated number of bushels of corn that would be required to meet such commitments. Petitioner relied also upon weekly and daily reports which it had filed with the Authority giving information as to its position with respect to grain futures. Petitioner had included in those reports, among other matters, detailed information as to its transactions in grain, and its purchase and sales commitments for grain, or grain products, and it stated in such reports that its futures were classifiable in character as hedging, rather than as speculative transactions. Petitioner was upheld in its con-

tentions in the proceeding before the Commodity Exchange Authority, and the action was dismissed.

See further R. 72–73, 76; *In re Corn Products Refining Co.*, 13 Agric. Dec. 1117, 1119, 1125, 1127–1128, 1132–1134.

The essential character of a manufacturer's hedging transactions, as we have seen, is that they are an integral part of its manufacturing operations. Taxpayer's present assertions that its futures dealings were for tax purposes separate and apart from its manufacturing operations must be considered in the light of the contrary assertions of record in the instant case, and further in the light of the fact that in 1940 it was able to convince the Department of Agriculture to the contrary with respect to some of the very transactions here in issue and with respect to a statutory provision under which a more technical concept of hedging is decisive.

The Tax Court found that "Petitioner's purchases of corn futures did not constitute speculative transactions for profit" (R. 206), and this was affirmed by the court of appeals (R. 297). In the circumstances, the conclusion of the two lower courts on this question, which is essentially factual, should not be disturbed. *Comstock* v. *Group of Investors*, 335 U. S. 211, 214. Given these facts, we submit that the conclusion of the court below is inescapable (R. 297):

> The property here was used for essentially the same purpose and in the same manner as in true hedging. Futures contracts were entered into to stabilize inventory costs and thus protect profit, and whether complete or only partial insurance was thereby obtained is simply a difference in degree, not in kind. Therefore, for the same reasons that the true hedge is not accorded capital treatment under Section 117 (a), the kind of transactions with which we are now concerned are not to be regarded as capital ones either.'

II

CORN FUTURES CONTRACTS ARE NOT WITHIN THE SCOPE OF SECTION 118 OF THE INTERNAL REVENUE CODE OF 1939

Section 118 of the Code provides that no deduction shall be allowed to a corporation under Code Section 23 (f) for "any loss * * * from any sale * * * of shares of stock or securities" if within 30 days before or after the sale the taxpayer has acquired "substantially identical stock or securities." Both the Court of Appeals and the Tax Court rejected the taxpayer's contention that its transactions in corn futures were subject to the provisions of Section 118—a contention made contrary to the position it had taken in its tax returns.[22]

[22] For the base period years of 1938 and 1939 alone, the taxpayer, by invoking the application of Section 118, would now eliminate losses aggregating over $3,150,000. (See Col. 15, Ex. 1-A, R. 230.)

If the Court sustains our contention that taxpayer's hedging gains and losses do not qualify for capital gains treatment (Point I, *supra*), it need not reach this issue. Taxpayer's hedging profits could then be treated like any other profits derived from its manufacturing operations, and its losses would be deductible as ordinary and necessary business expenses under Section 23 (a) (1) (A). Or, with equal propriety, such profits and losses could be reflected as they were on taxpayer's tax returns for the period in question (R. 204), through adjustments in the cost of goods sold. If this view is accepted no question would remain for decision under Section 118, because that section has reference only to the deductibility of any "loss" otherwise deductible "under section 23 (f)." The latter section plainly has nothing to do with the deductibility of ordinary business expenses, which is otherwise provided for in Section 23 (a).

If, however, this Court should hold, in disagreement with the courts below, that taxpayer's futures transactions are to be treated as resulting in capital gains or losses, then, for the reasons stated under points A and B, *infra*, we maintain that the wash loss limitations of Section 118 do not apply.

A. FUTURES CONTRACTS ARE NOT "SUBSTANTIALLY IDENTICAL" ONE WITH ANOTHER

Section 118 was enacted to prevent a deduction for losses sustained in wash sales of securities;

that is, where the taxpayer at or about the time of a sale acquires identical or substantially identical securities. The deduction is postponed until the securities are disposed of and not replaced within thirty days. The purpose of the section was to prevent the taking of a "fictitious loss" in order to acquire a tax advantage, where the taxpayer did not truly alter his economic position. See H. Rep. No. 350, 67th Cong., 1st Sess., pp. 10, 11 (1939–1 Cum. Bull. (Part 2) 168, 176, 177); S. Rep. No. 275, 67th Cong., 1st Sess., pp. 11–12, 14 (1939–1 Cum. Bull. (Part 2) 181, 189, 191); H. Conference Rep. No. 486, 67th Cong., 1st Sess., p. 24 (1939–1 Cum. Bull. (Part 2) 206, 214). The evil was deemed to be present only where the taxpayer sold and purchased "substantially identical" securities, for it was only in this circumstance that it could be said that a taxpayer had not changed his economic position.

Futures contracts, at least where they are of different maturities, do not meet this requirement (even if they be considered "securities"; but see pp. 52–58, *infra*). Inherently, a futures contract is nothing more than an agreement for the sale of a given quantity of a commodity to be delivered at a later date, and hence, there are obvious differences as to the identity of the sellers, the price and the delivery date. The most significant differences are, of course, in the time of delivery, since that is the cornerstone upon which the entire operation of the futures market is based. But for differences as to delivery dates, the futures com-

modity market as it is now operated on the various commodity exchanges would perform no useful function in our business and economic life. In the case of a manufacturer, the hedging process generally involves selling early maturities and buying later maturities, the volume of purchases varying with forward commitments. Indeed, trading in futures encompasses not only contracts for future delivery of the current year's crop but also contracts for future delivery of the crop which is yet to be harvested. Thus, in April of a given year a hedger may sell a contract calling for delivery of corn in May and purchase a contract calling for delivery of corn in December after another crop has been harvested. The two contracts are in no sense "substantially identical." Congress expressly recognized this when, in 1950 in another context, it provided in what became Code Section 117 (l) (3) (B) (ii), as added by Sec. 211, Revenue Act of 1950, c. 944, 64 Stat. 906, that "a commodity future requiring delivery in one calendar month shall not be considered as property substantially identical to another commodity future requiring delivery in a different calendar month * * *."

There is no merit to taxpayer's suggestion (Br. 48–49) that the "substantially identical" test is met because, even though there are different delivery dates, there is only a "small economic difference in the value of different maturities." This misrepresents the significance of price differentials in the

commodity markets, where trades frequently turn on changes in price of one-eighth of a cent. As shown in the table below,[23] moreover, price differentials between corn futures bearing different de-

[23] The daily current prices at Chicago for corn futures, on each of the dates indicated below, in 1942, show the following with respect to futures traded on that date for different delivery months (85th Annual Report of the Trade and Commerce of Chicago for 1942, by Chicago Board of Trade (Lincoln Printing Co., Chicago, 1943), pp. 56, 58, 60–62, 64, 66, 68, 70, 72, 74, 76, 78):

Date	Delivery Month	Delivery Month	Delivery Month	Delivery Month
Jan. 2	May: 84⅜-85⅜	July: 86⅛-87¼	September: 87½-88¾	
Feb. 2	May: 86¾-87⅝	July: 88⅜-89¼	September: 90-90⅞	
Mar. 2	March: 82⅝-83½	May: 86⅜-87	July: 88½-89	September: 90⅛-90⅞
Apr. 1	May: 88¼-88⅞	July: 90¾-91¼	September: 92¾-93⅜	
May 1	May: 83¼-85⅛	July: 86¼-88⅜	September: 88⅜-90⅜	
June 1	July: 86⅛-87⅛	September: 88¾-89⅝	December: 90⅞-92⅛	
July 1	July: 83½-87¼	September 88½-90	December: 91½-92¾	
Aug. 1	September: 87⅝-89	December: 90¼-91⅝	May: 94¼-95½	
Sept. 1	September: 83¼-84⅜	December: 86⅜-87½	May: 90-91	
Oct. 1	December: 85½-86¼	May: 90-90⅜	July: 91½-92	
Nov. 2	December: 79⅛-79⅞	May: 84½-85¼	July: 86¼-86⅞	
Dec. 1	December: 84½-85¼	May 89¾-90⅛	July: 91¼-92	

On occasion, the price of futures for different delivery months has varied even more sharply. For example, in August, 1937 the price for September delivery ranged from 90⅞ to 105⅞, and the price for December delivery ranged from 61¾ to 69⅞. See tables for Monthly Range of Prices, 85th Annual Report of the Trade and Commerce of Chicago for 1942, *supra*, p. 87.

livery dates were consistently substantial during the period in question.

Thus, in recognition of the fact that the purchase of a futures contract to replace one requiring earlier delivery is not a simple exchange of property "of a like kind" (see Code Section 112 (b) (1)), it has been held that sales of futures contracts are completed transactions when made, the gain or loss upon which is to be recognized at that time for tax purposes. *Valley Waste Mills* v. *Page*, 115 F. 2d 466 (C. A. 5th), certiorari denied, 312 U. S. 681; *Harriss* v. *Commissioner*, 143 F. 2d 279 (C. A. 2d), certiorari denied, 312 U. S. 681.

The conclusion of the courts below that the taxpayer was not engaged in "wash" sales of "substantially identical" contracts is confirmed by the fact that Section 4 (c) of the Commodity Exchange Act makes it unlawful to utilize trading in futures on a commodity exchange for the purpose of a "wash sale."[24] It should, of course, not be unnecessarily assumed that taxpayer en-

[24] Section 4c of the Commodity Exchange Act, c. 545, 49 Stat. 1491 (7 U. S. C., 1952 ed., Sec. 6c), provides that—

> It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of, any transaction involving any commodity, which is or may be used for (1) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (2) determining the price basis of any such transaction in interstate commerce in such commodity, or (3) delivering any such commodity sold, shipped, or re-

gaged in illegal transactions. *Korbly* v. *Springfield Inst. for Savgs.*, 245 U. S. 330, 336. See, in this connection, *In re Jean Goldwurm*, 7 Agric. Dec. 265, in which proceeding violations of the Commodity Exchange Act were charged with respect to certain transactions in futures allegedly "of the character of 'wash sales'" (*id.* at 268). In that opinion, it was stated that the "essential and identifying characteristic of a 'wash sale' seems to be the intent not to make a genuine, bona fide trading transaction in stocks or commodities. A wash sale is a form of fictitious transaction" (*id.* at 274).

We conclude that futures contracts are not "substantially identical", one with another, and that for that reason they fall outside the scope of Section 118 of the Code.

B. FUTURES CONTRACTS ARE NOT "SECURITIES" WITHIN THE MEANING OF THE TERM AS USED IN SECTION 118

Taxpayer's transactions in corn futures fail to qualify under the wash-sales provisions of Section 118 for the additional, independent reason that futures contracts, as further held by the two lower courts, are not "securities" as that term is used in Section 118.

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ceived in interstate commerce for the fulfillment thereof—

(A) if such transaction is, is of the character of, or is commonly known to the trade as, a "wash sale", "cross trade", or "accommodation trade", or is a fictitious sale;

* * * * * *

The word "securities" normally refers to evidence of debt or property, such as stocks, bonds, notes, and the like. Significantly, all of the definitions of "securities" contained in the Internal Revenue Code of 1939, as amended, omit futures contracts from their scope. See Sections 22 (b) (9), 23 (g) (3), 23 (k) (3), 117 (n) (3), 165 (b), 373 (f), and 3672 (b) (2).[25] The word "securities" is similarly employed in the trade, and it is distinguished from commodities and contracts for the sale thereof.[26] The fact

[25] The definition in Section 3672 covers Government and corporate bonds, debentures, etc., negotiable instruments, and money. Taxpayer implies that this definition covers futures contracts (Br. 44). This is not so, for futures contracts are not negotiable instruments. They do not, for example, contain an unconditional promise or order to pay a sum certain in money. See Beutel's Brannan *Negotiable Instruments Law* (7th ed.), p. 209 *et seq.*

[26] See, *e. g.*, Rules and Regulations of the Board of Trade of Chicago, contained in 85th Annual Report of the Trade and Commerce of Chicago, for 1942, Chicago Board of Trade (Lincoln Printing Co., Chicago, 1943). The Rules contain separate definitions for the terms "Commodity" (p. 204) and "Security or Securities" (p. 206), as follows:

> "*Commodity.*—Any commodity which may be dealt in under Rules or Regulations of the Association."
>
> "*Security or Securities.*—Stocks, Bonds, Notes, Certificates of Deposit or Participation, Trust Receipts, Rights, Warrants, and other similar instruments."

Similarly, there are separate provisions fixing the rates of brokerage for the purchase and sale of "commodities" (pp. 250-257) and fixing commissions on the execution of orders for the purchase and sale of "securities" (pp. 257-260); rules fixing places "on the floor" of the exchange for making "any

that the word is used in its usual and normal sense in Section 118 is borne out by the legislative history of the section, a consideration of its purpose, and its context in the Internal Revenue Code.

As we have seen, Section 118 was introduced into the Code to prevent the taking of fictitious losses (and the gaining of a tax advantage) through the sale of securities and their repurchase within a short period of time under circumstances where the person concerned did not alter his economic position. As the reports accompanying the legislation make clear, the practice was one typically engaged in by investors selling stocks to establish losses and then immediately repurchasing the same securities. Indeed, throughout the reports, the words "securities" and "shares of stock" are used interchangeably.[27]

Significantly, these same reports are barren of any suggestion that this same practice was

transaction in securities" and for making "any transaction for future delivery of a commodity" (pp. 262-263), etc. Taxpayer purchased most of its corn futures contracts on the Chicago exchange (R. 88).

[27] See H. Rep. No. 350, 67th Cong., 1st Sess., pp. 10, 11 (1939-1 Cum. Bull. (Part 2) 168, 176, 177); S. Rep. No. 275, 67th Cong., 1st Sess., pp. 11-12, 14 (1939-1 Cum. Bull. (Part 2) 181, 189, 191); H. Conf. Rep. No. 486, 67th Cong., 1st Sess., p. 24 (1939-1 Cum. Bull. (Part 2) 206, 214). Although the statutory language is "shares of stock or securities," the House and Senate reports refer only to "securities," and the Conference Report refers only to "shares of stock," thus indicating that the concern was with corporate securities.

deemed a problem requiring remedial legislation in the case of trading in commodity futures, although, of course, trading in futures was highly developed on the established commodity exchanges at the time. See, *e. g., Board of Trade* v. *Christie Grain & Stock Co.*, 198 U. S. 236; *United States* v. *Patten*, 226 U. S. 525. The reason for this must be, as noted by the Tax Court (R. 29), that commodity futures are "for such short periods and are of such a peculiar character that they do not lend themselves to the evil which section 118 was intended to prevent." Thus a person holding such futures could not build up an investment portfolio which he continues to carry over the years, while taking fictitious losses from time to time to offset gains which would otherwise be taxable. Because corn futures are of a maximum duration of 11 months, and because of the administrative cost of continually renewing holdings (see R. 55), there would be no tax saving incentive to the use of futures to establish fictitious losses.

On the other hand, if, contrary to our contentions, futures of different maturities should be considered substantially identical, Section 118 would have a different untoward result. If futures were considered securities within the meaning of Section 118, that Section would reach all processors who, in connection with their manufacturing operations, engage in hedging operations involving continual trading in futures.

The nature of hedging is such that the manufacturer who hedges generally works forward in the market, selling his contracts before they mature (or taking delivery) and purchasing new contracts to cover his new forward commitments. The effect of holding Section 118 applicable to futures would be to require losses, whenever a sale is followed or preceded by a purchase within 30 days, to be carried forward from year to year without being accorded tax recognition. This would not only be contrary to the fundamental pattern of the taxing statute which requires an annual accounting of business profits and losses, but would place the processor who assumes the risk of price changes in a different position from the one who transfers part or all of that risk to others by dealing in futures. It should not be lightly assumed, without warrant in the legislative history or in the text of the statute, that Congress intended this result.

Our conclusion that "securities" is used in Section 118 in its usual and normal sense is buttressed when other provisions of the Internal Revenue Code are considered. We have noted above that all definitions of the word "securities" contained in the Code exclude futures contracts from their scope. On the other hand, wherever Congress intended that a provision of the Code should cover both securities and commodity futures, it specifically so provided. See Section 332 (b), (c); Section 502 (b), (c); Section 117 (l) (3)

(B) (i) (added to the 1939 Code by Sec. 211 of the Internal Revenue Act of 1950, c. 994, 64 Stat. 906). Cf. Section 1233, Internal Revenue Code of 1954. The conclusion is inescapable that Congress has not used "securities" in Section 118 in the broad and unusual sense suggested by taxpayer.

Taxpayer relies on the contrary conclusion of the Court of Appeals for the Sixth Circuit in *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33, rehearing denied, 148 F. 2d 208 (Br. 45–48). But the court in that case made no reference to the legislative history of Section 118, to the definitions of "securities" contained in the Internal Revenue Code, or to the fact that Congress has invariably expressly referred to commodity futures when it intended to include them within the scope of a provision otherwise applicable to securities. That court based its decision rather on the notion that futures contracts were securities because they were pledged to the broker "who had advanced the necessary funds to purchase the oil" (147 F. 2d at 37), and because the owner "had no more than a document giving it the right to demand and receive property not in its possession" (*ibid.*). But, as the Tax Court pointed out (R. 28), any pledged property is a security in the former sense[28] and any executory contract giving a person the right

[28] The Tax Court added (R. 28): "Furthermore, the reasoning is unsound since the broker does not advance the funds necessary to purchase the commodity."

to demand and receive property upon the payment of a contract price is a security in the latter sense. Patently, pledged property in general and all executory contracts are not to be regarded as securities within the meaning of Section 118. The courts below correctly rejected the reasoning of the court in the *Trenton Cotton Oil* case. Futures contracts are not "securities" within the intendment of Section 118.

CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals is correct, and should be affirmed.

Respectfully submitted,

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APPENDIX

INTERNAL REVENUE CODE OF 1939

CHAPTER 1—INCOME TAX

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

(26 U. S. C. 1952 ed., Sec. 112.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject

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to the allowance for depreciation provided in section 23 (l) * * *;[54]

* * * * * *

(d) *Limitation on Capital Losses.*—

(1) *Corporations.*—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. * * *[55]

* * * * * *

(26 U. S. C. 1952 ed., Sec. 117.)

SEC. 118. LOSS FROM WASH SALES OF STOCK OR SECURITIES.

(a) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the

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[54] Section 117 (a) (1) was amended, in respects not here material, by Section 115 (b) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and by Section 151 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, which added provisions excluding Government obligations issued on a discount basis and real property used in trade or business, respectively.

[55] As applicable to the year 1942, after amendments by Section 212 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Section 150 (c) of the Revenue Act of 1942, *supra*, this provision was as follows:

(d) *Limitation on Capital Losses.*—

(1) *Corporations.*—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 23 (e) (2); nor shall such deduction be allowed under section 23 (f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business.

* * * * * *

(26 U. S. C. 1952 ed., Sec. 118.)

CHAPTER 2—ADDITIONAL INCOME TAXES

* * * * * *

SUBCHAPTER E—EXCESS PROFITS TAX

[As added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, which provided that the new subchapter may be cited as the "Excess Profits Tax Act of 1940"].

SEC. 710. IMPOSITION OF TAX.

(a) [as amended by Section 201 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Section 202 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Imposition.*—

(1) *General Rule.*—There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

* * * * * *

(b) [as amended by Section 2 (a) of the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, and by Sections 204 (a) and 205 (g) (1) of the Revenue Act of 1942, *supra*] *Definition of Adjusted Excess Profits Net Income.*—As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in Section 711) minus the sum of:

(1) *Specific exemption.*—A specific exemption of $5,000 * * *;

(2) *Excess profits credit.*—The amount of the excess profits credit allowed under Section 712; and

(3) *Unused excess profits credit.*—The amount of the unused excess profits credit adjustment for the taxable year, computed in accordance with subsection (c).

* * * * *

(26 U. S. C., 1952 ed., Sec. 710.)

SEC. 711. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * * * *

(B) [as amended by Section 207 (a) of the Revenue Act of 1942, *supra*] *Gains*

and Losses From Sales or Exchanges of Capital Assets.—There shall be excluded gains and losses from sales or exchanges of capital assets held for more than 6 months.

* * * * *

(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(26 U. S. C. 1952 ed., Sec. 711.)

SEC. 712 [as amended by Section 13 of the Excess Profits Tax Amendments of 1941, *supra*]. EXCESS PROFITS CREDIT—ALLOWANCE.

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 712.)

SEC. 713 [as amended by Section 4 (b) of the Excess Profits Tax Amendments of 1941, *supra*, and Sections 215 and 228 (e) (2) of the Revenue Act of 1942, *supra*]. EXCESS PROFITS CREDIT—BASED ON INCOME.

(a) *Amount of Excess Profits Credit.*—The excess profits credit for any taxable year, computed under this section shall be—

(1) *Domestic corporations.*—In the case of a domestic corporation—

(A) 95 per centum of the average base period net income, * * *

* * * * * *

(b) *Base Period.*—

(1) *Definition.*—As used in this section the term "base period"—

(A) If the corporation was in existence during the whole of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the period commencing with the beginning of its first taxable year beginning after December 31, 1935, and ending with the close of its last taxable year beginning before January 1, 1940; * * *

* * * * *

(d) *Average Base Period Net Income—Determination.*—

(1) *Definition.*—For the purposes of this section the average base period net income of the taxpayer shall be the amount determined under subsection (e), subject to the exception that if the aggregate excess profits net income for the last half of its base period, reduced by the aggregate of the deficits in excess profits net income for such half, is greater than such aggregate so reduced for the first half, then the average base period net income shall be the amount determined under subsection (f), if greater than the amount determined under subsection (e).

* * * * *

(e) *Average Base Period Net Income—General Average.*— The average base period net income determined under this subsection shall be determined as follows:

(1) By computing the aggregate of the excess profits net income for each of the taxable years of the taxpayer in the base period, reduced by the sum of the deficits in excess profits net income for each of such years. * * * ;

(2) By dividing the amount ascertained under paragraph (1) by the total number of months in all such taxable years; and

(3) By multiplying the amount ascertained under paragraph (2) by twelve.

(f) *Average Base Period Net Income—Increased Earnings in Last Half of Base Period.*— The average base period net income determined under this subsection shall be determined as follows:

(1) By computing, for each of the taxable years of the taxpayer in its base period, the excess profits net income for such year, or the deficit in excess profits net income for such year;

(2) By computing for each half of the base period the aggregate of the excess profits net income for each of the taxable years in such half reduced, if for one or more of such years there was a deficit in excess profits net income, by the sum of such deficits. For the purposes of such computation, if any taxable year is partly within each half of the base period there shall be allocated to the first

half an amount of the excess profits net income or deficit in excess profits net income, as the case may be, for such taxable year, which bears the same ratio thereto as the number of months falling within such half bears to the entire number of months in such taxable year; and the remainder shall be allocated to the second half;

(3) If the amount ascertained under paragraph (2) for the second half is greater than the amount ascertained for the first half, by dividing the difference by two;

(4) By adding the amount ascertained under paragraph (3) to the amount ascertained under paragraph (2) for the second half of the base period;

(5) By dividing the amount found under paragraph (4) by the number of months in the second half of the base period and by multiplying the result by twelve;

(6) The amount ascertained under paragraph (5) shall be the average base period net income determined under this subsection, except that the average base period net income determined under this subsection shall in no case be greater than the highest excess profits net income for any taxable year in the base period. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 713.)

SEC. 728. MEANING OF TERMS USED.

The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

(26 U. S. C. 1952 ed., Sec. 728.)

SEC. 729. LAWS APPLICABLE.

(a) *General Rule.*—All provisions of law (including penalties) applicable in respect to the taxes imposed by Chapter 1, shall, insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter.

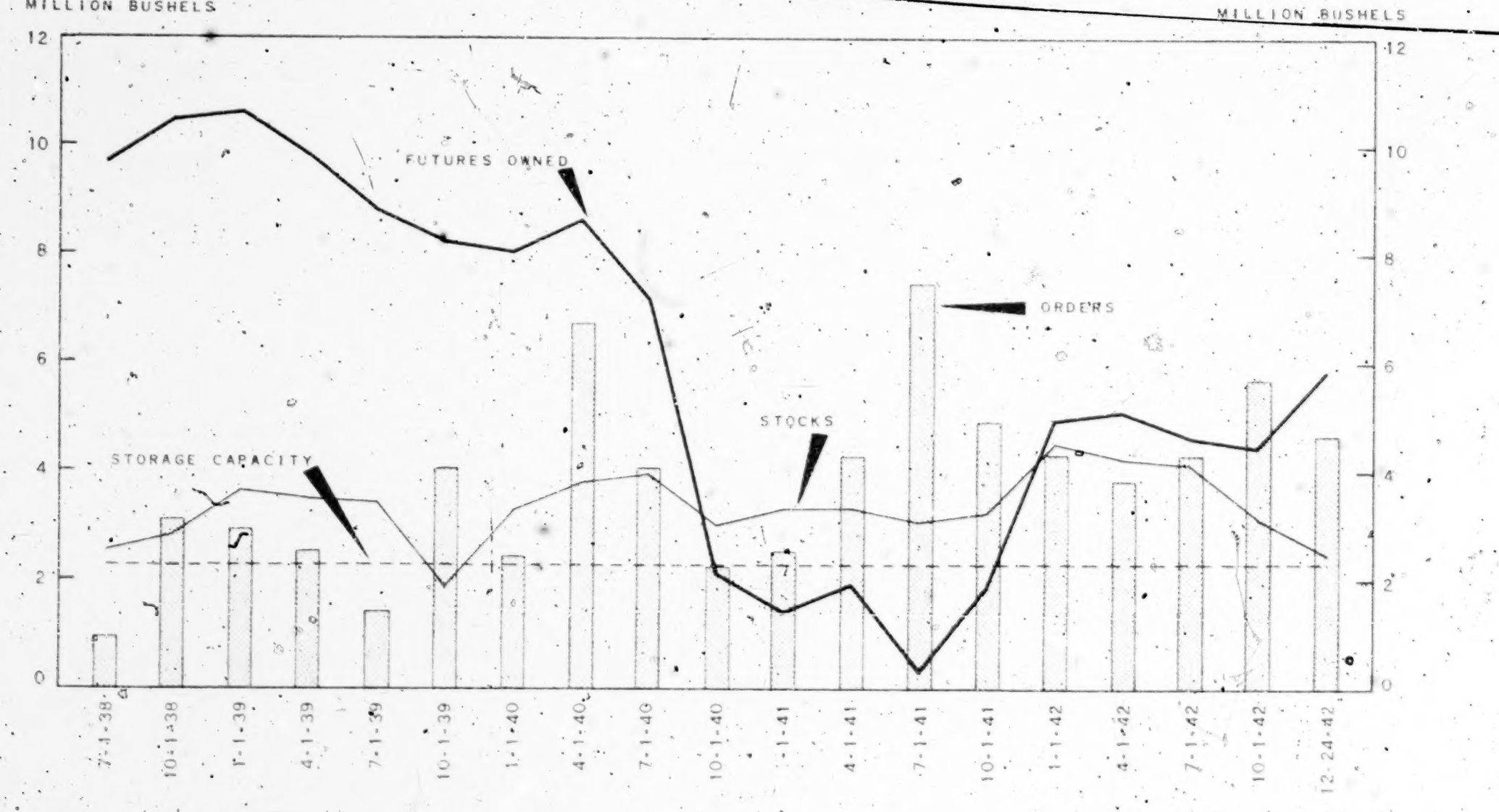
* * * * *

(26 U. S. C. 1952 ed., Sec. 729.)

U. S. GOVERNMENT PRINTING OFFICE 1955

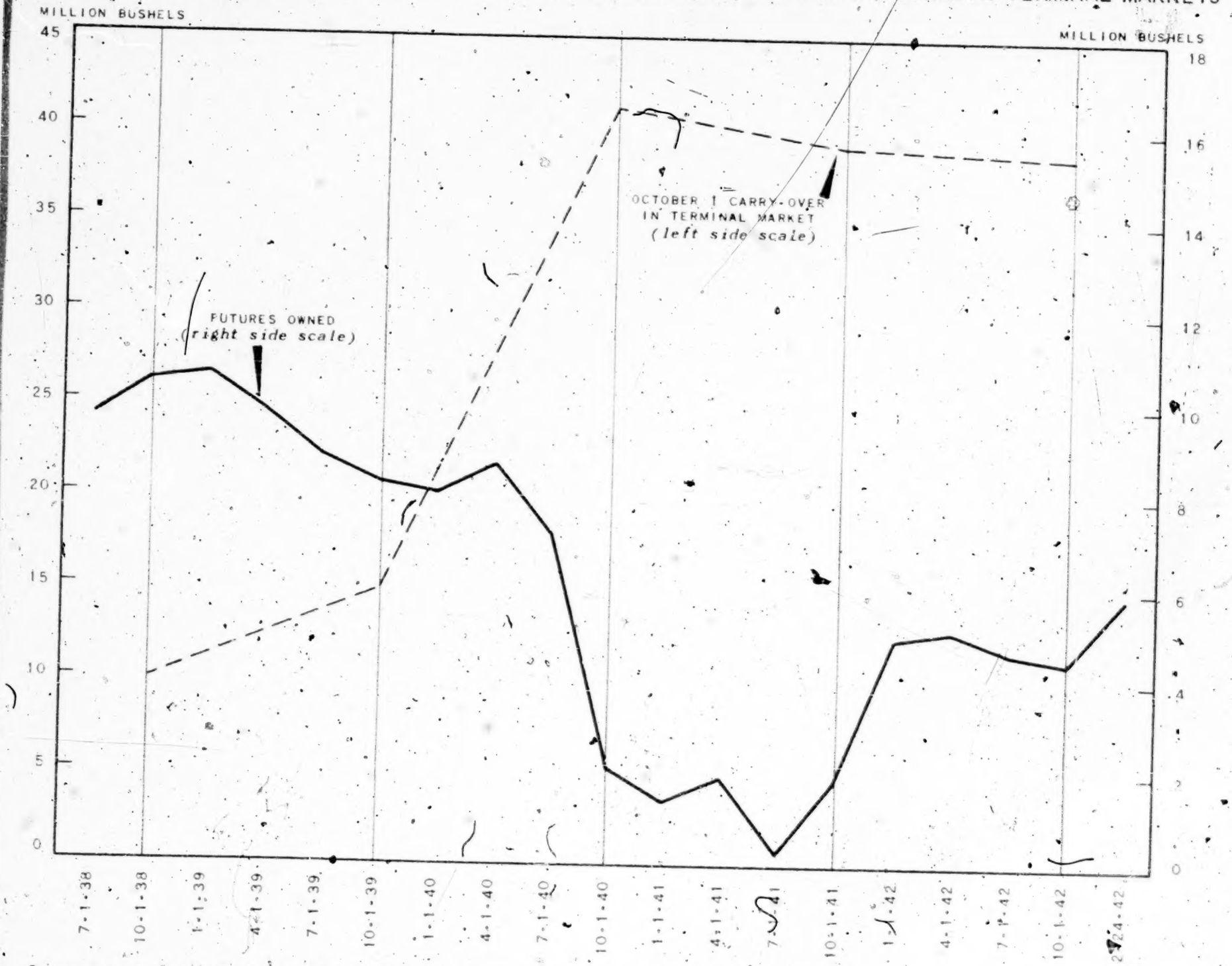
Commissioner's Chart No. 1

Corn Products Refining Company: ORDERS, STORAGE CAPACITY, STOCKS, AND FUTURES OWNED



Commissioner's Chart No. 2

Corn Products Refining Company: FUTURES OWNED AND COMMERCIAL CORN CARRY-OVERS AT TERMINAL MARKETS



Source: Agricultural Statistics, 1945, United States Department of Agriculture, p. 45, Table 51.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 20

CORN PRODUCTS REFINING COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REHEARING

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CORN PRODUCTS REFINING COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner petitions for a rehearing pursuant to Rule 58 of the Rules of this Court. The decision of this Court was handed down on November 7, 1955.

Grounds for Rehearing

THIS COURT'S DECISION IN THE INSTANT CASE, AS EXPLAINED IN ITS OPINION

I. OVERLOOKS VITAL LEGISLATIVE HISTORY,

II. DOES NOT FOLLOW ITS OWN ESTABLISHED AND APPLICABLE RULES OF STATUTORY CONSTRUCTION,

III. STEMS FROM A MISREADING OF THE AUTHORITIES ON A VITAL POINT,

IV. WILL LEAD TO UNCERTAINTY AND MULTITUDINOUS LITIGATION.

A REHEARING SHOULD BE GRANTED IN THE INTERESTS OF JUSTICE AND GOOD TAX ADMINISTRATION.

Introduction

The instant case presents the question of whether certain purchases and sales of corn futures by Petitioner fall within the purview of Section 117 of the Internal Revenue Code. This Court has answered that question in the negative.

Petitioner believes that it can demonstrate that the decision in the instant case overlooks vital legislative history which clearly indicates a Congressional intention with respect to Section 117 completely at variance with that stated in the opinion.

Furthermore, Petitioner does not believe that this Court could have adverted to, or that Respondent desires, the uncertainty and multitudinous litigation that the scope of the opinion in the instant case will, it is believed, entail. In this connection Petitioner quotes two excerpts from the November 11, 1955 issue of a Research Institute of America bulletin (Appendix A contains the entire discussion of the subject):

"The Supreme Court's decision on hedging

transactions has shaken the established concept of capital gains and losses."

"Observation: The *Corn Products* decision is an invitation to litigation and a step toward uncertainty in the important area of capital gains. The Supreme Court's judicial modification of the statutory rules on capital gains and losses can only compound the difficulties of distinguishing between ordinary income and loss and capital gain and loss."

There is such widespread interest in the decision in the instant case and its effects will be so far reaching that Petitioner earnestly entreats this Court to re-examine its decision.

I

One of the main bases for this Court's decision seems to be that Petitioner's corn futures purchases and sales were an integral part of its business, designed to protect its manufacturing operations against a price increase in its principal raw material and to assure a ready supply of the same for future manufacturing requirements. As the opinion states (p. 4):

"Under these facts it is difficult to imagine a program more closely geared to a company's manufacturing enterprise or more important to its successful operation."

From the foregoing this Court reaches the conclusion that Petitioner's corn futures activities did not fall within the purview of Section 117 and consequently would not be given capital gain or loss treatment. The opinion is not clear just how this conclusion follows. Presumably the connecting link between premise and conclusion is to be found in another part of the opinion[1] where this Court says "Congress intended that profits and losses arising from the every day operation of a business be considered as ordinary income or loss rather than capital gain or loss", and, "The preferential treatment provided by Section 117 applies to transactions in property which are not the normal source of business income". (p. 6).

Petitioner has been unable to find anything that would support the validity of the above quotations with respect to the intent of Congress and the application of Section 117. The opinion offers no foundation or supporting material. It does state, though, in the course of amplifying the above quotations, that it was the intention of Congress in Section 117 to relieve a taxpayer from excessive tax burdens on gains, citing *Burnet* v. *Harmel*, 287 U. S. 103, and that since such relief was an exception from normal tax requirements, "*the definition of capital assets must be narrowly applied . . . to effectuate the basic Congressional purpose.*" (p. 6) (emphasis supplied).

[1] Which is concerned with a totally different point, the hedging exception.

Petitioner submits, with the greatest deference, that this Court has overlooked vital legislative history that quite definitely indicates that Congress intended that the definition of capital assets, as it existed at the time pertinent to the instant case, be given a broad, if not the broadest, application, and not a narrow application. If this be true, then, the basic Congressional purpose must be different from the one which a narrow application of the capital assets definition would effectuate, and cannot be the one set forth in the above quotations with respect to the intent of Congress and the application of Section 117.

Burnet v. *Harmel*, cited with approval by this Court as above set forth, was decided under the 1924 Revenue Act. At that time, Section 206, the predecessor of Section 117, was concerned with the problem of relief for taxpayers who had gains from the sale of certain assets. But Section 117 as it was adopted in 1934 (and as it existed, with certain minor changes, in the 1939 Internal Revenue Code which is applicable to the instant case) was concerned with a totally different problem.

The totally different problem was that men of wealth were offsetting their income with losses[2] on sales of their property. This they were assisted in doing be-

[2] It will be remembered that the early thirties were depression years and losses on sales of property were the order of the day.

cause of, among other things, the narrowness of the definition of capital assets in Section 206.

This Court appears to have overlooked the difference between the gain problem that Section 206 was primarily intended to cope with and the loss problem that Section 117 was primarily intended to cope with. Indeed, this Court's preoccupation with the gains aspect of the Section can be seen from its reference to the "preferential treatment provided by Section 117" (p. 6) as supporting its position.

In fact, there are two aspects to Section 117, one involving gains (where preferential treatment is provided in limited situations) and the other involving loss (where in all situations rigorous treatment, the antithesis of preferential, is provided). But it was with the loss aspect that Congress was primarily and seriously concerned[3] when it redefined capital assets in Section 117(b)[4] in 1934 and added Section 117(d). It wanted a broad definition of the term. By such a definition it would be better able to reach the evil, i. e., the deductibility of losses on sales of assets, which it sought to minimize.

The strict limitation of losses on the sale of assets is the key to the true Congressional intent for the instant case. A narrow interpretation of the term

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[3] See Seidman's Legislative History of Federal Income Tax Laws, 1938-1861, pp. 360-369

[4] The predecessor of Section 117(a) of the 1939 Internal Revenue Code.

capital assets does not serve this intent while a broad interpretation does.

Thus we find the House Ways and Means Committee (73rd Cong., 2nd Sess., H. R. 704, p. 31) stating:

> "Subsection (b) defines capital assets. It will be noted that the definition includes all property except as specifically excluded."

This language was adopted in Reg. 86 of the Revenue Act of 1934, Reg. 94 of the Revenue Act of 1936, Reg. 101 of the Revenue Act of 1938 and Reg. 103 of the Internal Revenue Code of 1939.

Petitioner respectfully submits that this Court's attention has been misdirected from the true Congressional intent. The foregoing summary statement of the legislative history of the Section and the evil sought to be remedied therein clearly indicates anything but a narrow interpretation of the definition of capital assets in Section 117(a). It clearly indicates the Congressional preoccupation with losses on sales of property. It reveals an intent and desire that these be limited severely and not be deductible except where (and to the extent) definitely and specifically authorized. It clearly indicates that Congress intended exactly what it said (see Point II). It clearly indicates that the decision of this Court will, by narrow interpretation of capital and consequent easing of the loss limitation frustrate, rather than effectuate, the basic purpose of Congress.

II

It is a cardinal rule of statutory construction, enunciated by this Court on countless occasions, that when the language of a statute is clear and unambiguous, Courts are bound to look for the intention of Congress in the words of the statute itself. To state the rule in another way: Congress intended what it unequivocally said and if the language employed is explicit it affords conclusive evidence of the Congressional intent. A corollary to this rule is that when the words of a statute have a plain and obvious meaning, such meaning cannot be extended or restricted by conjecture or under the guise or pretext of interpretation. This rule and corollary are, it is submitted, applicable in the instant case, and indicate with almost mathematical precision that Petitioner's corn futures transactions should be given capital treatment.

Congress set forth its intent in respect of capital gains and losses, as far as the facts of the instant case are concerned, in Section 117(a). There is no question but that the language used in the Section is clear and unambiguous. At no place has this Court said it was not. In this language Congress picked its way meticulously through all classes of sales. It designated some (all except those specifically excluded) for capital treatment and others (those specifically excluded) for non-capital treatment. The language, given its normal and natural meaning, is

clear that Petitioner's corn futures activities were such as to require capital treatment.[5]

There are no words in Section 117, that given their normal meaning, say that all sales of assets that are an integral part of a taxpayer's business are excluded from capital gain and loss treatment, as this Court concludes. The Section is explicit to the contrary. It almost seems as if Congress anticipated the point. It provided for the inclusion of some sales and the exclusion of others. Either class of sales, whether included or excluded, could involve the sale of property. This might, or might not (and it was immaterial which) be "connected with a trade or business", as an integral part thereof or otherwise.

A further rule of statutory construction, which this Court ignores in its decision, is that where a statute sets up a general rule and enumerates specific exceptions, further exceptions by way of mere implication are not permissible.[6] Section 117(a) sets up a general definition of capital assets. From this general definition specific exceptions are carved out. The

[5] The opinion states (p. 6) that "Petitioner's corn futures do not come within the literal language of the exclusions" in Section 117(a). This, of course, is tantamount to saying that Petitioner's corn futures come literally within the definition of capital assets in Section 117(a).

[6] *Richfield Oil Corporation* v. *State Board*, 329 U. S. 69 (1946); *Moore Ice Cream Company* v. *Rose*, 289 U. S. 373 (1933); *Cunard S. S. Co.* v. *Mellon*, 262 U. S. 100 (1923); *Addison* v. *Holly Hill Co.*, 322 U. S. 607 (1944); *Brooks* v. *St. Louis-San Francisco Ry. Co.*, 180 F. 2d 185 (8th Cir. 1950).

foregoing rule of statutory construction would proscribe further exceptions by mere implication.

The plain language of the statute, which under the applicable rules of statutory construction should control, will not, it is submitted with the greatest deference, support this Court's statements (1) that Congress intended that gains and losses arising from the every day operation of a business be ordinary income and losses and (2) that the so-called preferential treatment provided by Section 117 is restricted to transactions which are not the normal source of business income. It is difficult to see how Congress could have said more clearly in its language that neither statement was true. It is easy to see how Congress could have clearly said that which would have made them true. This Court's statements with respect to intent of Congress and the application of Section 117 are at best but rough approximations or oversimplified generalizations of the meticulous particularizations of Section 117. However, Congress decided on minute and specific instructions and not on general directions. A reading of the provisions of Section 117 as a whole should bring conviction on this score.

III

One of the main bases for this Court's decision is that hedging is an exception to Section 117(a). The opinion states that hedging as an exception to Sec-

tion 117(a) was first voiced by the Treasury in G. C. M. 17322,[7] that the courts have followed the proposition, and that Congress has, by reenacting the Code on three different occasions in light of that background, given approval to it.

Let us, however, examine the precise proposition that the G. C. M. voiced—the precise proposition that was followed by the courts and approved by Congress.

The proposition was quite simple. It was that "true hedging" was an exception to Section 117(a). Not something roughly akin to hedging, but "true hedging". A reading of the G. C. M. makes this abundantly clear. The examples set forth in G. C. M. 17322 are all examples of "true hedging", i. e., where there is a balanced market position, where a profit is fixed or insured, not, as in the instant case, where only the risk of the price going one way is eliminated.

All the cases on the subject,[8] with the exception of the instant case, are to the same effect. Almost all of them use the words "true hedging", and all of them quite clearly mean that.

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[7] XV-2 Cum. Bul. 151.

[8] *Ben Grote*, 41 B. T. A. 247 (1940); *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F. (2d) 772 (5th Cir. 1941), cert. denied, 314 U. S. 683 (1941); *Kenneth S. Battelle*, 47 B. T. A. 117 (1942); *Tennessee Egg Co.*, 47 B. T. A. 558 (1942); *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. (2d) 33 (6th Cir. 1945), affirming T. C. Memo Op. (Dec. 28, 1943); *Estate of Dorothy Makransky*, 5 T. C. 397 (1945), aff. 154 F. (2d) 59 (3rd Cir. 1946); *Stewart Silk Corp.*, 9 T. C. 174 (1947); *Fulton Bag & Cotton Mills*, 22 T. C. 1044 (1954).

In *Makransky v. Commissioner*, 5 T. C. 397 (1945), aff'd (3rd Cir. 1946) 154 F. (2d) 59, on which Petitioner relies,[9] the taxpayer there had the same sort of partial insurance that Petitioner in the instant case had. Since, however, the taxpayer in the *Makransky* case did not have a "true hedge", it was denied a fully deductible loss. It was told that it had a capital loss by the Commissioner of Internal Revenue and the Courts, whose consistency in these cases has been noted by this Court in its opinion (p. 7).

It was the "true hedging" concept, no other, that Congress approved. This can be seen from this Court's quote in its opinion (p. 7, footnote 9) from H. R. Report No. 1337, 83rd Cong., 2d Sess., p. A278; S. Rep. No. 1622, 83rd Cong., 2d Sess., p. 437, as follows:

> "Under existing law *bona fide* hedging transactions do not result in capital gains or losses. This result is based upon case law and regulations." (Emphasis Supplied).

In view of the fact that the "case law and regulations"[10] on which the quote is based both posit the criterion of "true hedge", it is clear that "true hedging" was intended. No other meaning squares with the "case law and the regulations".

---

[9] This was a basic case on which the Writ of Certiorari in the instant case was granted. This Court cites this case in its opinion, but never discusses it.

[10] In point of fact G. C. M. 17322 never was promulgated into Regulation.

This Court has overlooked the fact that for the hedging exception to Section 117(a) a "true hedge" is requisite. The requisite was set up by the Commissioner of Internal Revenue, the Courts and Congress, the authorities on which this Court's conclusion is based that hedging is an exception to Section 117(a).

Although this Court doesn't seem to have squarely passed on the question of whether or not Petitioner had a "true hedge", such indication as there is on the point in the opinion seems quite clearly to be that Petitioner did not have a "true hedge" (p. 5).[11] If Petitioner did not have a "true hedge", Section 117 is operative and Petitioner's corn futures transactions give rise to capital gains and losses.

As a matter of fact, Petitioner did not have a "true hedge". For a complete discussion of this point, see the initial brief of Petitioner (Brief, pp. 23-28).

IV

By far the most devastating effect of the decision in the instant case is that it has opened a veritable Pandora's Box of uncertainties.[12] Confusion and multitudinous litigation will inevitably result, and neither is desirable.

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[11] The fact found and stated by both The Tax Court and the Circuit Court of Appeals was that Petitioner did not have a "true hedge".

[12] *Research Institute of America*, 1955 Edition: N. F. 7 November 11, 1955, p. 3. "The decision goes far beyond a mere settlement of the hedge situation. It puts the stamp of approval on a new theory of capital assets which may create substantial uncertainty in the area of capital gains and losses.

From its opinion, it is apparent that the criteria that this Court has adopted for determining whether sales of assets produce capital gains and losses or ordinary income and losses are the following:

(1) If the profits and losses (from the sales of assets) arise from the every day operation of a business, they are to be considered as ordinary income and losses.

(2) If the profits and losses (from the sales of assets) arise from transactions which are not the normal source of business' income, they are capital gains and losses.

(3) If the profits and losses (from the sales of assets) arise from transactions that are an integral part of a business or are geared to a company's business or are important for its successful operation, the are ordinary income and losses.

(4) If the profits and losses (from the sales of assets) arise from transactions that are not an integral part of a business, or are not geared to a company's business, or are not important for its successful operations, they are capital gains and losses.

These criteria are a far cry from Section 117 and its definition of capital assets in subsection 117(a). The uncertain, indeterminate, and disputable limits of such criteria are readily manifest. The possibilities of litigation are, as a consequence, limitless.

Consider the case of a manufacturing company. It needs large amounts of working capital from time to time. It can keep its working capital in cash, but more than likely, pending actual need for it, it will keep a good part of it in bonds or in stocks so that it will not be idle and unproductive. From time to time, as cash is needed, the stocks and bonds are sold. How should the gains or losses from these transactions be treated? Reference to Section 117, the Congressional enactment on the point, clearly indicates capital treatment.

But under the decision in the instant case, a real question will exist.

Working capital is vital to the success of the company and so is its investment. The latter is one of the normal, natural every day operations of the company (one of the Treasurer's or Finance Committee's regular duties is supervising investment). It is a regular and normal source of income. It is geared to the company's business and if it is an integral part of it. Will ordinary income or loss result under the decision in the instant case, and if there is a loss, will the limitation provisions of Section 117(d) apply? This can hardly be said to effectuate the basic purpose of Congress to limit severely losses on the sale of property unless the property sold could be fitted into certain specific classes (the exclusions in Section 117(a)).

In *Commissioner* v. *Baglin & Sewall Co.* (2nd Cir. 1955) — F. (2d) — affirming 20 T. C. 983 the tax-

payer, a contractor, was required under a contract to put up bonds as security for his proper performance. The taxpayer put up the bonds as required, performed the contract, and, on receiving back the bonds, sold them at a loss. He sought to deduct the loss in full as an ordinary loss. The Commissioner of Internal Revenue objected that the loss was a capital loss. Under Section 117 it seemed clear that the taxpayer's loss was a capital loss. The Circuit Court of Appeals, however, departing far from the words of Section 117, held that a fully deductible loss resulted. Mr. Justice Frank in a dissenting opinion made the following pertinent remarks:

> "The last clause of Section 117(a)(1) is illuminating: 'From "capital assets" it excepts "real property"—no other—if "used in the trade or business of the taxpayer.' My colleagues, in effect, treat that clause as if it read 'any property used in the trade or business of the taxpayer.' This, I think, an improper judicial amendment of the statute.
>
> * * * *
>
> "My conclusion here derives from no ardent desire to add to the government's revenues by invariably interpreting statutes adverse to taxpayers; see, e. g., my dissenting opinion in *Babcock & Wilson (sic) Co.* v. *Pedrick*, 217 Fed. (2d) 654 (C. A. 2). But I think that courts should not allow what they deem fairness to taxpayers to override one of the most sensible canons of

statutory construction, i. e., that, where a statute sets forth specific exceptions, further exceptions, by way of mere implication are not permissible. Moreover, to hold for the taxpayer here may well mean unfairness to other taxpayers who, having acquired securities in situations just like this, but having made a gain on the sale of the securities, seek to claim that their taxable profits are capital gains, not ordinary income."

If the decision in the instant case stands, the holding of the majority in the *Bagley* case has been approved. Section 117, as written, becomes to all practical purposes a dead letter. Purpose, motive and design of a sale become the important relevant factors, not the nature of the assets as Congress intended. Such certainty as the numerous cases decided under the Section had developed over the years is gone. The loss limitation dike erected by Congress has been breached. The Commissioner of Internal Revenue cannot possibly want this result, as witness his opposition in the *Bagley* case.

There are other recognizable areas of probable confusion and litigation. Good will and customer's lists are often acquired by a business. Stock in other corporations is often purchased to insure a source of supply or a new customer. All these assets can be purchased and sold as part of normal business operations. What treatment will now be afforded on their sale? This Court's decision makes the answer doubtful.

Conclusion

Congress set down a great many words in Section 117, presumably after considerable thought and the advice of tax experts, both Government and public. This Court has not said that the meaning of the words as applicable to the instant case are unclear or ambiguous, and indeed they are not. And yet the plain meaning of the words is not followed. As a consequence, the true intention of Congress is overlooked. Its serious concern for the deduction of losses and its desire to limit them is not carried out. So too, this Court's orderly system of statutory construction is not followed. It is not believed that in the long run the Treasury will benefit. Certainly every sale transaction under the new, more or less protean, criteria established or presaged by the decision in the instant case will present infinite uncertainties and concomitant possibilities of litigation. This latter result seems inevitable and most undesirable, and one to which it is not believed this Court, in its consideration of the practicalities involved, could have adverted.

It is respectfully requested that this petition for rehearing be granted.

Dated, November 29, 1955.

Respectfully submitted,

SAMUEL A. MCCAIN
JAY O. KRAMER
Counsel for Petitioner

Certificate of Counsel

We, SAMUEL A. McCAIN and JAY O. KRAMER, counsel for the above named petitioner, do hereby certify that the foregoing Petition for a Rehearing of this cause is presented in good faith and not for delay.

SAMUEL A. McCAIN
JAY O. KRAMER

Dated: New York, New York,
November 29, 1955.

APPENDIX A

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The Supreme Court's decision on hedging transactions has shaken the established concept of capital gains and losses. Here's what happened: The Corn Products Refining Co. used futures contracts in connection with manufacturing products made from grain corn. In order to get an adequate supply of raw corn economically, it would buy futures when the prices appeared favorable. It would take delivery on some contracts and sell others. The company claimed that while hedging transactions gave rise to ordinary income, these dealings were not true hedges and therefore the results should have been capital gains and losses. The Supreme Court held that the gains or losses were ordinary income or loss because (1) the practice of buying futures was an integral part of the taxpayer's business, (2) despite lower court holdings that the taxpayer's activities didn't constitute "true hedging", the transactions were in the nature of a hedge, which is excluded from capital gains treatment, and (3) to allow a capital gain would open a loophole whereby those engaged in hedging operations could convert ordinary income into capital gain.

The Court also had before it the question of whether the "wash sales" provision applies to futures contracts. (This bars a loss on stock or securities if they are repurchased in a 61-day period.) Since the Court decided that ordinary income or loss resulted,

it didn't have to decide whether the wash sales provision applied. (*Corn Products Refining Co. v. Com.*, S. Ct., 11/7/55)

The decision goes far beyond a mere settlement of the hedge situation. It puts the stamp of approval on a *new theory of capital assets* which may create substantial uncertainty in the area of capital gains and losses.

As the tax *statute* reads, there is first a clear, unambiguous statement that "capital assets" means "property held by the taxpayer *(whether or not connected with his trade or business)*". The statute then goes on to say that this "does not include" and lists a series of specific property classes, the most common of which are inventory, property held for sale to customers, and real or depreciable property used in the trade or business. For years, this statutory provision has been interpreted to mean that property is a capital asset (giving capital gain or loss on sale) unless it falls within the statutory exceptions to capital assets.

But the Supreme Court's language seems to end this approach. It said "Admittedly, petitioner's corn futures do not come within the literal language of the exclusions set out in that section. They were not stock in trade . . ." etc. "But the capital asset provision of § 117 must not be so broadly applied as to defeat rather than further the purpose of Congress : . . Congress intended that profits and losses arising from the every-day operation of a business be considered as ordinary income or loss rather than capital gain or loss . . . the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly."

True, this part of the Court's decision was concerned with the fact that "hedges" had long ago been removed from the capital gain and loss area by a Treasury rule which Congress had never overridden in the revenue acts passed since then. But, the *language* is *not* specifically limited to hedges and will certainly be used to reinforce those lower court decisions which have already allowed *ordinary losses* on sale of securities which were acquired for necessary business reasons. It also reinforces a developing tendency on the part of the Tax Court to permit capital gain only in connection with *investments*. The result can be to question such well accepted capital gains as the sale of stock or securities by a trader.

Observation: In following the trend towards limiting the capital gain treatment to investments, the Supreme Court said of the taxpayer's argument: "this is not the talk of the capital investor but of the far-sighted manufacturer". And in discussing the intention of the capital gain section of the law it quoted an earlier Supreme Court case which said that its purpose was "to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments . . ." But note that the statute itself never once uses the word "investment" in defining capital assets.

Observation: In the particular tax year involved, the taxpayer suffered a loss from its futures transactions. But the Court's decision covered gains as well, because the taxpayer realized a gain on its futures transactions in other years involved in the case.

Planning for capital gain tax saving was also hit. The Court offered as a final reason for its conclusion that: "To hold otherwise would permit those engaged

in hedging transactions to transmute ordinary income into capital gain at will. . . . if a sale of the future created a capital transaction while delivery of the commodity under the same future did not, a loophole in the statute would be created and the purpose of Congress frustrated." This kind of approach could raise hob with other established capital gain situations. For example, a stockholder can realize a potential dividend as a capital gain by selling just before the record date which establishes who gets the dividend. If he doesn't sell, the dividend will come in as ordinary income. Is this a loophole to be blocked by a court decision? Or suppose an endowment policyholder sells at a profit before his policy matures. Is this a loophole which the courts can close?

Observation: The *Corn Products* decision is an invitation to litigation and a step toward uncertainty in the important area of capital gains. The Supreme Court's judicial modification of the statutory rules on capital gains and losses can only compound the difficulties of distinguishing between ordinary income and loss and capital gain and loss.

SUPREME COURT, U.S.
SEP 10 1954
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

October Term, 1954

No. 20

JAMES R. ELLIS, as President of the Yonkers Committee for Peace, an unincorporated association,

Petitioner,

—against—

WILLIAM DIXON, *et al.*, as members of the Board of Education of the City of Yonkers, etc.,

Respondents.

ON A WRIT OF CERTIORARI TO THE APPELLATE DIVISION OF THE SUPREME COURT OF THE STATE OF NEW YORK, SECOND DEPARTMENT

SUPPLEMENT TO PETITION FOR REHEARING

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SUPPLEMENT TO PETITION FOR REHEARING

Since the filing of the Petition for Rehearing during vacation, on June 27, 1955, the following additional points suggested themselves, and petitioner urges their consideration in connection with the Petition for Rehearing.

1. It is respectfully urged that the dismissal of the writ because the decision below could rest on an adequate non-federal ground, is an inadvertence procedurally. The issues should have been decided on the merits. The Court held that a state question remained open, because the

pleading failed to adequately plead discrimination, *i.e.*, it failed to allege that organizations similar to petitioner were granted the use of the schoolroom. But this allegation goes to the heart of the federal question whether enough has been alleged to show a denial of a constitutional right. The allegations themselves therefore present a federal question which no state court could preclude this Court from reviewing. Therefore, the federal question was adequately presented.

For instance, if the state court had expressly said (as distinct from the inferences that appear in the opinion) that petitioner did not show a clear right to relief because he had not alleged that *similar* organizations were granted the use, but not he, a federal question would arise. *It would present the federal question whether such an allegation is necessary to secure a right claimed to have been denied under the federal Constitution.* It is therefore respectfully submitted that the conclusion, "the state court's decision rested on an adequate non-federal ground" is not correct. (This is recognized by the opinion, page 5, where it is said, "It is established law that this Court is not finally concluded by the state court's determination as to the sufficiency of pleadings asserting a federal right". It would follow that this statement—this premise—in the opinion should have led to a conclusion entirely different from the one reached. The failure to do so points up an inconsistency that cannot be reconciled.)

2. As to the remark in the opinion that the record is empty and inadequate on which to decide the constitutional issue on its merits, it is urged that there are sufficient

facts as a matter of pleading. This was briefed in Petition for Rehearing.

The Court will agree that pleadings should be concise and to the point. Indeed, the New York law, Section 1288 provides that the petition "shall contain a plain and concise statement of the material facts on which the petitioner relies". To say now that the pleading is "empty" because it is not replete with extraneous matters or loaded with evidentiary claims is to deny effect to the New York statute. What this petitioner did was to comply with the New York law, by concisely alleging the material facts to show a denial of a right under the Constitution. Conciseness cannot be fairly equated with emptiness, nor is verbosity a substitute for substance. It is submitted, that as a pleading, sufficient material facts were shown to warrant a disposition of the case upon its merits.

A recent case involving the disposition of an important Constitutional issue on a pleading is found in Joint Anti-Fascist Refugee, 341 U. S. 123.

The Court should be greatly inclined to have this issue adjudicated on its merits. This problem is recurrent, as indicated in the Petition for Writ of a Certiorari, page 2. Since this Court's decision on June 6, 1955 in this case, a similar case arose again on the pleadings in the Supreme Court, Westchester County, *Hooker* v. *Conte*, New York Law Journal, July 18, 1955, page 5.

Respectfully submitted,

EMANUEL REDFIELD
Counsel for Petitioner